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REVIEW OF WORLD BANK CONDITIONALITY

THE WORLD BANK

GOOD PRACTICE PRINCIPLES FOR CONDITIONALITY

Ownership:	Reinforce country ownership.
Harmonization:	Agree up-front with the government and other financial partners on a coordinated accountability framework.
Customization:	Customize the accountability framework and modalities of Bank support to country circumstances.
Criticality:	Choose only actions critical for achieving results as conditions for disbursement.
Transparency and predictability:	Conduct transparent progress reviews conducive to predictable and performance-based financial support.

REVIEW OF WORLD BANK CONDITIONALITY

OPERATIONS POLICY AND COUNTRY SERVICES
WORLD BANK

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ABBREVIATIONS AND ACRONYMS

CAS	Country Assistance Strategy
CPIA	Country Policy and Institutional Assessment
CSO	Civil society organization
DPL	Development policy lending
FY	Fiscal year
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
LDP	Letter of Development Policy
LIC	Low-income country
MDG	Millennium Development Goal
MOU	Memorandum of Understanding
MIC	Middle-income country
PAF	Performance assessment framework
OED	Operations Evaluation Department
OP	Operational Policy (statement)
OPCS	Operations Policy and Country Services
PRS	Poverty reduction strategy
PRSC	Poverty reduction support credit
PRSP	Poverty Reduction Strategy Paper

REVIEW OF WORLD BANK CONDITIONALITY

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REVIEW OF CONDITIONALITY

PREFACE

This volume presents key findings of the review of World Bank conditionality associated with the World Bank's policy-based lending. It documents the evolution in the Bank's approach to conditionality, takes stock of recent experience, looks anew at the Bank's practice, and presents a set of good practice principles to guide future policy-based lending.

The review was undertaken between November 2004 and July 2005 in response to a request by the Development Committee in October 2004. It involved extensive consultations and a series of workshops and with governments, donors, development practitioners and civil society organizations, and other parties interested in contributing to the debate. This volume presents an overview of the review, summarizes the key messages of the consultations and discusses the results of an extensive survey conducted among officials from borrowing governments on the effectiveness of World Bank conditionality. A set of background papers addressing a number of keys issues related to the conditionality debate are contained in this volume, including modalities, legal aspects, recent trends, content, IMF-Bank coordination, and a literature survey. In addition, a stocktaking of the poverty reduction support credits and a series of good practice notes for development policy lending have been issued separately. The Bank also published the volume *Conditionality Revisited,* which presents a range of views on the topic.

The review of World Bank conditionality was undertaken by a team of staff (from OPCS, as well as the Legal, Poverty Reduction and Economic Management, and Development Economics networks) and consultants coordinated by Stefan Koeberle. The main authors were Zhanar Abdildina, Harold Bedoya, Allison Berg, Adrian Fozzard, John Factora, Egbert Gerken, Jaime Jaramillo-Vallejo, Stefano Paternostro, David Peretz, Vikram Raghavan, Jan Walliser, Waly Wane, and Adriana Weisman, with key contributions from Luis Alvaro Sanchez, Hassane Cisse, Sarah Cliffe, Jean-Jacques Dethier, Kai Kaiser, Veronique Kessler, Silvana Kostenbaum, Lili Liu, Young Moo Kim, Xavier Nogales, Zoran Stavreski, Gero Verheyen, and Tevfik Yaprak. The survey was undertaken by Fusion Analytics LLC. Henry Chase, Sheldon Lippman, and Patricia Rogers provided editorial advice. Pansy Chintha and Philomene Koya were responsible for logistic support and document processing. The review benefited from guidance by the Bankwide panel on conditionality and comments by Regional and Network colleagues. The close cooperation with Tessa van der Willigen and Juan Zalzuendo from the IMF is gratefully acknowledged. The work was undertaken with the guidance of Jim Adams, Vice President of OPCS.

REVIEW OF WORLD BANK CONDITIONALITY

EXECUTIVE SUMMARY

The 2005 review of the conditionality associated with the World Bank's policy-based lending[1] documents the evolution in the Bank's approach to conditionality, takes stock of recent experience, and takes a fresh look at the Bank's practice. It responds to the Development Committee's October 2004 request for a review of the Bank's "policy and practice on conditionality," and a "report on the continued efforts by the Bank and the Fund to streamline their aggregate conditionality."[2]

Conditionality Review. The review, undertaken over the past eight months, consisted of a broad work program that involved several workshops and discussions with governments, donors, development practitioners, civil society organizations, and other parties interested in contributing to the debate.

Definition. For the purpose of the review, conditionality has been defined in line with the provisions of Operational Policy (OP) 8.60, *Development Policy Lending*. The policy specifies that the Bank makes its resources available if the borrower (a) maintains an adequate macroeconomic framework, (b) implements its overall program in a manner satisfactory to the Bank, and (c) complies with the policy and institutional actions that are deemed critical for the implementation and expected results of the supported program.

Changing Approaches. The Bank's understanding of conditionality has undergone significant change—from the early emphasis on actions for macroeconomic adjustment and growth, to more recent attention to the different design aspects of conditionality, including those associated with initiatives to enhance country ownership of programs and streamline conditionality and with Bank-Fund collaboration. Today the Bank takes a flexible approach to conditionality as evidence of a borrower's commitment to its program, suitably combined with capacity building. This approach has been embedded in programmatic lending and the new operational policy for policy-based lending.[3]

Trends. The Bank's use of conditions has declined sharply over the past decade: the average number of conditions per operation fell from 35 in the late 1980s to about 12 in FY05, across all Regions and for different groups of borrowers. However, the use of indicative actions describing the overall government program (so-called benchmarks) has increased from about 15 to 24 per operation on average, largely on account of their use in programmatic policy matrices in IDA countries. Over the past decade, the content of conditionality has shifted from short-term economic adjustment to complex medium-term institutional changes such as public sector governance and social sectors reforms. In particularly sensitive policy areas, such as privatization and trade liberalization, conditionality has declined and now focuses more on long-term institutional issues. Aggregate Bank-Fund conditionality has also declined. The decline in conditionality in IBRD countries largely derives from the Bank's efforts, while that in IDA countries reflects a more significant contribution from the Fund. Both institutions have concentrated increasingly on areas of their expertise, and when accounting for policy dialogue outside of areas addressed by conditionality, there is no evidence for systematic gaps in coverage.

Implementation Challenges. Consultations and analytic work identified a number of areas where good practice could help reduce some of the tensions within conditionality and its application. Examples of such challenges for the implementation of conditionality include the following: the principle of respecting country ownership may be at variance with the need of financial partners to ensure that aid is spent well; predictability of resource flows could be undermined if weak performance results in reduced or withheld funding; increasing the size and specificity of policy matrices used for multi-sector or multi-donor operations could increase their complexity and intrusiveness; and flexibility in programmatic settings may result in lack of consistency in the application of performance standards.

Main Messages. The review suggests a few main messages that will be reflected in a broader communication effort:

- The operational policy framework for development policy lending adopted in August 2004 was confirmed to be robust, and the Bank has the capacity to apply best practices under this umbrella. The operational policy is consistent with a view that conditionality is not coercion to undertake reform, and does not prescribe policy content.
- In its operational work, the Bank has fully recognized the importance of country ownership for development effectiveness. Like other development partners, it is grappling with the practical challenges of assessing ownership and responding to changing policy environments.
- The Bank has made important strides in adapting its policy-based lending to complex reform programs and focusing on critical actions. However, it needs to be careful to avoid an increasing use of large and complex policy matrices, particularly in multisectoral operations and when coordinating with other donors.
- The Bank's conditions and expected prior actions (triggers) have typically been transparently disclosed and clearly defined. However,

the flexibility of programmatic approaches, which allows adapting prior actions for subsequent operations, needs to be exercised cautiously to balance predictability with performance.

- The Bank's approach is fully compatible with the goal of harmonizing financial support with other development partners while retaining the Bank's distinct accountability.

Good Practice Principles. The review suggests a number of good practice principles to further strengthen the Bank's approach to conditionality. They will be further developed, widely shared with staff, and used to improve future development policy loans.

- Actively reinforce country ownership by relying on clear evidence of ownership informed by analytic work.
- Agree up-front with the government and other financial partners on a coordinated accountability framework which includes both policy actions and outcome indicators.
- Customize the accountability framework used to evaluate country performance under the program and modalities of Bank support to country circumstances. Do not use the framework to leverage additional reforms outside the government's agenda.
- Choose only actions critical for achieving results as conditions for disbursement.
- Conduct transparent progress reviews conducive to predictable and performance-based financial support.

Next Steps and Implementation. Following the Development Committee meeting in September 2005, the Bank will focus on disseminating the findings of the conditionality review and implementing the good practice principles. The Bank will use interaction of Bank operational staff and country offices with borrowers, as well as international fora and workshops with other development partners, to share its findings of the review. It will be important to ensure that the good practice principles are consistently applied in the design, monitoring and evaluation of development policy lending. Bank Management will use guidance notes, staff training, and the corporate review process on specific operations to advise and support operational teams.

REVIEW OF WORLD BANK CONDITIONALITY

I. INTRODUCTION

Conditionality has been a subject of debate ever since policy-based lending became an important instrument of World Bank financial support in the early 1980s. Many donors and lending institutions use conditions, often with different objectives. The World Bank uses conditionality for two reasons: to ensure that the assistance it provides contributes to the country's development objectives (development effectiveness rationale), and to ensure that the resources are used for the purposes intended (fiduciary rationale). The challenge is to find a set of conditions that meets these objectives and is monitorable with little ambiguity.

Evolution of Conditionality. The conditions in the structural adjustment programs of the 1980s and 1990s generally addressed short-term macroeconomic imbalances and economic distortions by resolving some of the short-term imbalances and creating potential for higher growth. In many cases, conditionality was critical for the advancement of first-generation reforms. However, at times the reforms were insufficiently owned by the country, subject to policy reversals, and were perceived as overly excessive or intrusive. Reviews of the effectiveness of development assistance over the past decades have demonstrated that reforms are more likely to be sustained when the reform program emerges from a country's own domestic political process and is suited to that country's specific circumstances.[4] As a result, the past few years have seen the emergence of new approaches to policy-based lending, and the practice of conditionality itself has evolved with increased efforts by the IMF, the World Bank, and other development partners to analyze and improve the effectiveness of their support. These efforts have been reflected in improvements in compliance, outcome, and sustainability ratings of policy-based lending during the past decade, as measured by the World Bank's independent Operations Evaluation Department (OED).[5] However, the development community continues to face practical questions regarding the appropriate type and nature of the conditions to attach to their support for recipient countries' development programs.

Objectives of the Review. In this context, in October 2004 the Development Committee requested a review of the Bank's "policy and practice on conditionality," and a "report on the continued efforts by the Bank and the Fund to streamline their aggregate conditionality."[6] This report responds to that request. It summarizes the findings of a review carried out during FY05 of the conditionality associated with the World Bank's policy-based lending,[7] which documents the evolution in the Bank's approach to conditionality, takes stock of the lessons of experience, and takes a fresh look at the Bank's practice of conditionality. The Bank's review of its conditionality was carried out in the context of reviews of Bank-Fund collaboration,[8] and was coordinated with the IMF's review of its own conditionality.[9]

Process and Products. Undertaken over an eight-month period, the review involved several workshops, a survey of country authorities, and discussions with Executive Directors, governments, donors, development practitioners, civil society organizations (CSOs), and other parties interested in contributing to the debate (see Annex A). The review drew on a considerable body of existing research, including work carried out by the Bank itself, experiences of other international financial institutions, position papers by bilateral donors, the academic literature, and analysis by CSOs.[10] A series of issues notes, research papers, and good practice notes were prepared to address different aspects of the experience and practice of conditionality (see Annex B). The work program, background papers, and successive versions of the summary findings, key messages, and suggested good practice principles were discussed by the Bank's Executive Directors between January and September 2005.[11]

Structure of the Paper. Following this introduction, Section II discusses the context, modalities, and approaches to conditionality; Section III presents recent trends in the World Bank's conditionality; and Section IV frames the key implementation challenges that arise in the practice of conditionality. Section V presents key messages of the review, and Section VI outlines suggested good practice principles to guide the future use of conditionality, and sets out next steps for the Bank.

II. Conditionality: Context, Modalities, and Approaches

Conditionality links financial support to the implementation of a program of reforms that are considered critical for the country's economic and social development. This section defines conditionality for the purpose of this review, describes its modalities in the context of World Bank operations, and discusses changing approaches to it.

A. Context

After a quarter-century of policy-based lending by the World Bank and of structural adjustment programs supported by the IMF, the term *conditionality* has sometimes been interpreted in different ways by country authorities, staff, academics, and outside observers.[12] It has been associated by some with all types of activities a country may need to undertake to gain access to or influence the level of financing—including, for example, actions that borrowers need to take to meet the World Bank's operational policies or the selectivity embedded in performance-based aid allocations. Others consider the ratings of the Country Policy and Institutional Assessment (CPIA), a summary rating of a country's policy environment that affects IDA aid volumes, as additional conditionality. In the extreme case, any interaction of the Bank with country authorities on economic policies and outcomes has been seen as conditionality, in the sense that the outcome of these interactions affects ultimate financing decisions and borrower behavior. For the purpose of this review, it is therefore necessary to define the use of term "conditionality" and distinguish it from other considerations.

Context of Conditionality: Selectivity Criteria. Conditionality applied at the level of the specific lending operation is distinct from other broader considerations in Bank lending.[13] These considerations are generally associated with selectivity criteria for making resources available to borrowing countries. Such criteria are based on broad assessments of a country's policy environment rather than the implementation of any specific policy or institutional action, and often change only slowly over time. In particular, accessing Bank lending requires that

- the country has its own development program (reflected in government strategy documents, especially—in low-income countries—a Poverty Reduction Strategy Paper, or PRSP) that sets out the country's development priorities and strategy;
- the Bank's Country Assistance Strategy (CAS) defines a results framework for CAS outcomes to which the Bank's interventions

contribute, and indicates a notional lending envelope and instrument mix, including development policy operations where appropriate;[14] and

- the country is considered sufficiently creditworthy for additional lending if it is an IBRD borrower; or for low-income countries, additional resources are available from IDA on the basis of a formula that takes into account population, per capita income, CPIA ratings, a governance factor, and the country's implementation of its existing Bank portfolio.

Considerations specifically concerning development policy lending also include the assessment of ownership of the program of policy or institutional actions, the country's track record, analytic underpinnings, poverty and social impact analysis, environmental considerations, adequacy of fiduciary arrangements, and participatory processes.[15]

Definition of World Bank Conditionality. Conditionality in the World Bank context and for the purposes of this review is defined as the set of conditions that, in line with the Bank's Operational Policy (OP) 8.60, para. 13, must be satisfied for the Bank to make disbursements in a development policy operation.[16] These conditions are (a) maintenance of an adequate macroeconomic policy framework, (b) implementation of the overall program in a manner satisfactory to the Bank, and (c) implementation of the policy and institutional actions that are deemed critical for the implementation and expected results of the supported program. Only these conditions are included in the Bank's loan agreements.

B. Modalities

The Bank applies conditionality in a variety of settings. This section summarizes the key modalities of conditionality and introduces relevant terminology.

Prior Actions and Tranche-Release Conditions. Policy-based loans can be structured as either single-tranche or multiple-tranche operations.[17] In either case, the funding is available only when the borrower accomplishes critical policy and institutional actions, or loan conditions.

- In a *single-tranche operation*, a program's critical conditions are usually met before the operation is presented to the Board of Executive Directors for approval. These conditions are referred to as *prior actions* and are listed in a schedule to the legal agreement.

- In a *multitranche operation*—in which the loan is disbursed in several tranches—the borrower complies with certain conditions after Board approval and effectiveness. These conditions are in addition to any conditions the borrower must meet for the operation to be presented to the Board. They are termed “tranche-release” conditions, because they must be satisfied before a tranche may be released, and they are listed in a schedule to the legal agreement. If they are not satisfied, the tranche may be released only if the Board approves a waiver of the conditions.

Triggers and Benchmarks. Aside from the critical policy and institutional actions that constitute loan conditions, a policy-based operation usually includes other substantive elements that embed the operation in a medium-term framework of government policies.[18]

- ***Triggers.*** Triggers are an important design element of programmatic policy-based lending, which usually consists of a series of single-tranche operations in support of a government’s medium-term program.[19] Triggers represent a notional set of expected prior actions for future operations that are critical for achieving and sustaining the results of the medium-term program. Compliance with triggers indicates sufficient progress to move from one operation to the next (as long as the satisfactory macroeconomic policy framework and program implementation requirements are met). Using triggers as indicative measures of progress provides greater operational flexibility than using tranche-release conditions, because triggers can be adapted more easily to a changing program environment. Bank operational documents are expected to lay out how triggers were adapted and modified to support program objectives before being converted into the prior actions of a follow-on operation.

- ***Benchmarks.*** Benchmarks in program matrices describe the contents and results of the government’s program in areas monitored by the Bank. They are frequently used to describe small steps in a reform process (such as the preparation of studies and action plans) that represent significant, though not necessarily critical, progress markers for the implementation of the program. Although they help define an area of the Bank’s policy involvement, they are not determinative of disbursements of Bank loans or grants and are not intended to become prior actions for future support.

Triggers and benchmarks are not reflected in a lending operation’s legal agreements as “conditions.” They represent an indicative understanding of measures under the overall policy program that a country intends to implement, and are used as a reference framework and management tool.

Conditionality in Investment Lending. The Bank generally discourages the use of conditionality in investment lending.[20] Nonetheless, investment projects may sometimes include agreements on particular policy undertakings that are important for achieving the project's objectives. In particular, sectorwide approaches and adaptable program loans may involve an understanding between the Bank and the recipient government on a sectoral development program. While such cases are outside the purview of this review, some of its conclusions and principles may be broadly applicable to them.

C. Changing Approaches

The Bank's understanding of conditionality has undergone significant change—from the early emphasis on actions for macroeconomic adjustment and growth, to more recent attention to the different design aspects of conditionality, including those associated with initiatives to enhance country ownership of programs and streamline conditionality and with Bank-Fund collaboration.[21] Today the Bank takes a flexible approach to conditionality as evidence of a borrower's commitment to its program, suitably combined with capacity building. This approach has been embedded in programmatic lending and the new operational policy for policy-based lending.[22]

Emergence of Programmatic Lending. The Bank is increasingly using a programmatic approach for its policy-based lending.[23] This approach involves a series of single-tranche operations that are sequentially presented to the Bank's Board of Executive Directors, with a medium-term framework specified at the outset—including completed prior actions, monitorable progress indicators, and expected prior actions (triggers) for subsequent operations.[24] This approach combines the discipline of a medium-term framework with triggers for subsequent operations that offer the flexibility to accommodate the unpredictability and uncertainty of complex policy reforms. Unlike traditional multitranche operations, which relied on promises for future actions to justify disbursements, each single-tranche loan under a programmatic approach is approved following actual performance—that is, on the basis of already completed actions—and thus contributes to systematic policy implementation.[25] Typically, programmatic lending is used to support complex medium-term institutional reforms. To the extent possible, programmatic approaches align disbursements with the borrowing country's financing needs during the annual budget cycle. In low-income countries, the poverty reduction support credit (PRSC) is a programmatic development policy loan designed to assist well-performing countries in implementing their poverty reduction strategy.[26]

From Adjustment Lending to Development Policy Lending. In August 2004, the Bank issued a new operational policy statement for use by Bank staff.[27] In replacing the previous guidelines, the Bank retired prescriptive passages on specific policy areas, such as privatization, financial sector reform, and public sector reform, because it had recognized that generalized prescriptions often fail and policies need to be country- and time-specific. The new development policy lending explicitly aims at supporting a country's program of policy and institutional actions to promote growth and achieve sustainable reductions in poverty. These programs are expected to be based on country and sectorwide analytic work (carried out by the country itself, third parties, or the Bank); in addition, operations need to assess the country's fiduciary arrangements; the policy effects on its environment, including forests and other natural resources; and the likely poverty and social impacts of key policies supported by the operation. As regards conditionality, the new policy mandates that conditions should be confined to those actions that are critical for implementing the country's program to achieve the expected results. Programs under the new policy are expected to reflect policies that have been developed in consultation with stakeholders in the country, and to include a results framework that allows adequate monitoring and evaluation.

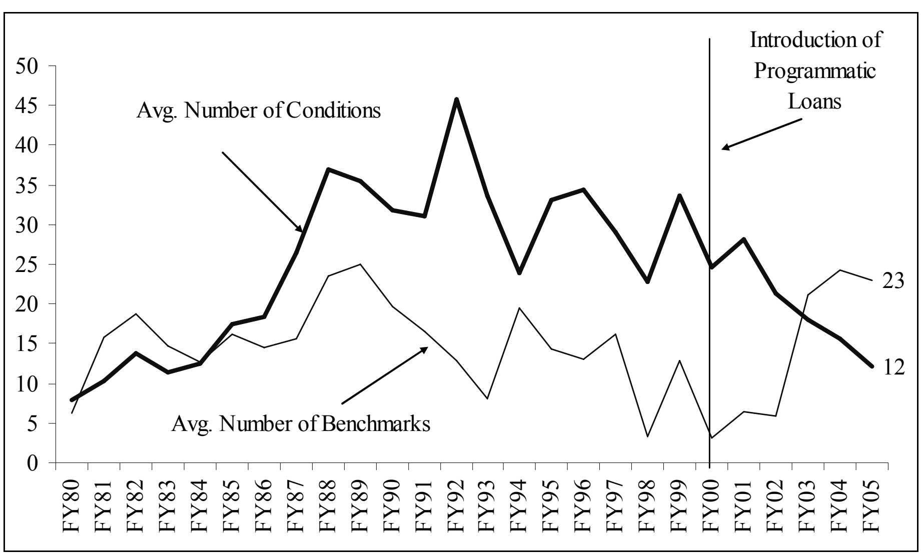
III. TRENDS IN WORLD BANK CONDITIONALITY

Discussions of conditionality frequently focus on the average number of conditions per loan or tranche. The number of conditions and benchmarks has raised concerns of "overloading" the policy agenda and "intrusiveness," notably in low-income countries. However, although the number of conditions may give an indication of the breadth of engagement and program monitoring, it says little about the actual use of conditions, conditionality content, and potential impact. For example, neither the number of conditions nor the size of the policy matrix would necessarily represent an additional burden for governments if the conditions were fully aligned with the government's own intentions and timing. The relevance and impact of conditions also can differ greatly depending on the modality (e.g., tranche-release conditions or indicative prior actions), their thematic areas of engagement, and the specific formulation of conditions. This section therefore summarizes not only findings on the numbers of conditions in Bank loans but also reviews conditionality content and quality.

A. Numbers

Overall World Bank conditionality as measured by the number of conditions has been sharply reduced. The average number of conditions per World Bank policy-based operation has declined from above 35 in the late 1980s and early 1990s to about 12 in FY05 (see Figure 1).[28] This trend can be found in all Regions, and in all types of borrowing countries, whether IBRD or IDA borrowers.[29]

Figure 1. Average Number of Conditions and Benchmarks per Lending Operation, FY1980-2005



Source: ALCID, World Bank.

Number of Benchmarks. By contrast, the number of indicative benchmarks in Bank-supported policy-based operations has increased from an average of about 15 in the early 1990s to around 23-24 in the last two fiscal years. The increased use of benchmarks is highly concentrated in programmatic operations in IDA countries, in particular in PRSCs; in core IDA countries, the use of benchmarks per lending operation has risen from 5-10 in the mid-1990s to over 35 in recent years.

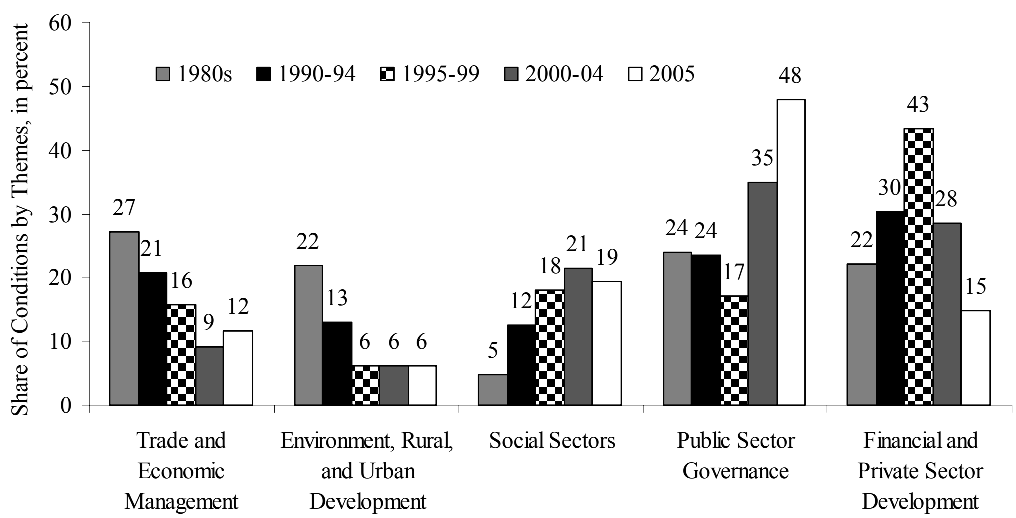
Aggregate Bank-Fund Conditionality. Aggregate conditionality with the IMF has declined; and there is no discernable evidence of a systematic gap in covering key areas of the country policy dialogue.[30] The framework for Bank-Fund collaboration introduced in 2001[31] encourages the staffs of the two institutions to provide more coherent support to countries through early and systematic coordination on programs and conditionality, with each institution focusing its conditionality on those areas that are deemed critical for the success of its program.[32] In 30 countries with parallel Bank- and Fund-supported programs, aggregate conditionality (measured per program year for comparability reasons) declined by 25 percent for middle-income countries and by 14 percent for low-income countries when comparing the periods before and after 2000.[33] In middle-income countries, this decline in aggregate conditionality can be attributed to a 50 percent decline in conditions in World Bank programs. By contrast, declines in conditions under the IMF's operations contributed more significantly to declining aggregate conditionality in low-income countries. The decline in conditionality in both Bank and IMF programs can be attributed to both institutions' concentration on core areas of expertise. When accounting for the Bank's extensive policy dialogue, there appears to be no evidence of systematic gaps in coverage across both institutions; this issue will be kept under review through the regular reviews of Bank-Fund collaboration.

B. Content

The lessons of the 1990s show that generalized policy prescriptions often fail, and that there is no single model of development.[34] Difficult institutional reforms such as privatizations and trade reform are unlikely to be successful unless there is strong political commitment combined with wider public understanding of and support for the process.[35] However, development research recognizes that sustainable growth and development are usually based on critical foundations, namely institutions that provide dependable property rights, manage conflict, ensure the rule of law, and align economic incentives with social benefits and costs. Acquiring these institutions often requires experimentation, willingness to depart from orthodoxy, and attention to local conditions.[36] These lessons are being reflected in the evolving content of conditionality.

Content Trends. Over the past two decades, the content of the Bank's conditionality in policy-based lending has broadly moved away from its traditional focus on short-term macroeconomic adjustment and removing major economic distortions toward support for medium-term institutional changes that are complex and often inherently unpredictable (see Figure 2). To some extent these shifts reflect a changing focus of many countries' policy agendas. For example, trade policy issues are of lesser importance following the significant reduction of trade barriers across the world. In recent years, the content of conditionality has strongly emphasized improvements in public sector governance: support for government efforts to strengthen public financial management, fiduciary arrangements, public expenditures, and public sector reforms now account of the largest share of conditionality. The use of conditionality has increased in the social sectors and declined in the areas of environment, rural development, and urban development, as well in trade and economic management. However, reforms in the financial sector and private sector development continue to be important areas of Bank engagement, but with a focus on improving business environments rather than on privatization.

Figure 2. Trends in the Share of Conditions by Thematic Area, FY95-05



Source: ALCID, World Bank.

Sensitive Structural Policy Areas. In particularly sensitive policy areas, conditionality has declined and now focuses more on long-term institutional issues.[37]

- ***The emphasis on privatization has strongly declined since the 1990s.*** The shift away from privatization is related to the increased attention to the quality of the investment climate as a whole. In noncompetitive sectors, independent of the ownership structure, the institutional framework has become central to the design of reforms.
- ***Conditionality on user fees is extremely limited.*** Conditions on user fees figure more prominently in the power sector (Eastern Europe and Latin America). There are virtually no such conditions in basic health, education, and water; and when such conditions are used they may actually call for the removal of user fees or the design of targeted schemes to improve access for the poor.
- ***Conditionality on trade has declined significantly since the mid-1980s*** with the increasing importance of international bodies, notably the World Trade Organization, in the trade area. The focus of remaining conditions is on institutional issues, such as the performance of customs agencies, product quality, and certification, rather than tariff rates or trade liberalization.

C. Compliance and Quality

Several indicators point to improvements in the development impact of Bank support through policy-based operations.[38] In a survey of country authorities conducted for the conditionality review, 88 percent of respondents agreed that Bank-supported programs have a positive overall development impact; large proportions also felt that Bank-supported programs improve growth prospects (82 percent) and contribute to poverty reduction (66 percent), and that the Bank is helpful in setting up systems to monitor and evaluate program outcomes.[39] Similarly, OED evaluations indicate that policy-based operations increasingly meet their development objectives: OED satisfactory outcome scores for policy-based lending increased from 60 percent in the 1980s to 68 percent in FY90–94, then rose to 82 percent in FY00–04. Finally, the recent review of PRSCs finds that only 5 percent of triggers were not met at the time of Board approval of the subsequent operation. (see paragraph on Graduated Response, p. 17)

Sustainability and Institutional Development Impact. In the survey, governments responded with a large majority that implementation of policy reforms continues after Bank operations close (77 percent) and that Bank work on institutions has a positive impact (83 percent). According to OED ratings, the likely sustainability of policy-based operations increased considerably, from 31 percent in FY85-89 to 83 percent in FY00–04, as did their institutional development impact, which rose from 26 percent to 50 percent.

IV. Applying Conditionality

The conditionality review has provided an opportunity to explore important issues about the application of conditionality, which are being discussed by the development community, including bilateral donors. Notably, the review examined a number of tensions or implementation challenges in the application of conditionality. These relate to the objectives of country ownership, which may not always align with the Bank's responsibility to ensure that scarce financial resources are used effectively; the notion of performance-orientation of financial support, which could test the predictability of resource flows; and the importance of flexibility to respond to unforeseen circumstances in the context of difficult policy changes, which may lead to divergences from a consistent and specific plan. The review also examined the issues of reducing the transaction costs of conditionality through improved coordination with financial partners; designing the scope and specificity of the policy matrix; aligning conditionality with countries' accountability frameworks; and customizing programs to country circumstances.

A. Implementation Challenges

1. Country Ownership and Fiduciary Accountability

A critical lesson of the research on aid effectiveness is the importance of a country's ownership: financial partners can advise on and support, but cannot buy or induce, economic reforms.[40] Experience shows that development financing with strong conditionality but without strong domestic leadership and political support has generally failed to produce lasting change.[41] When there is ownership, conditionality allows the borrowing country and the Bank to develop and nurture mutual trust and commitment. The Bank's operational policy recognizes the importance of country ownership, requiring that the Bank's decision to extend development policy lending to a country take into account the country's commitment to and ownership of the program, and its track record of reform.[42]

Assessing Ownership. In practice, the level of ownership is not easy to assess. Careful review of the country's political economy and of stakeholders' concerns is required to identify the scope for a sustainable reform program. Given the complexity of country situations, such an assessment goes beyond a simplistic notion of ownership that presupposes a uniform government position or a full consensus. It would not be sensible to suppose that all recipient countries are functioning democracies, respond to the interests of the majority of the population, avoid elite or foreign-interest capture, and maintain a stable course on reforms. A realistic assessment of ownership relies on the government's track record of reform and acknowledges the political economy dimensions that reforms may be owned by some constituencies and opposed by others who stand to lose from them.[43]

Consultation Feedback on Ownership. During consultations for the conditionality review, a strong degree of country ownership was widely seen as key to successful policy implementation, with some criticism that conditionality tends to undermine rather than strengthen ownership when it is perceived as imposed.[44] Countries perceive conditionality as less of a burden if the Bank program has been embedded in their own economic policies and programs. Most developing countries see themselves as taking charge of their development strategies and in general welcome access to the global development knowledge of the Bank and other development partners through a process of dialogue. However, some people—particularly representatives of civil society—are concerned that, given the power imbalance, this dialogue itself can become controlling and intrusive, undermining ownership.

Survey Results on Ownership. Sixty-nine percent of survey participants reported that their country has a development strategy that is widely owned, and 85 percent agreed the Bank-supported program was well aligned with their country's own medium- and long-term development strategy.[45] A large majority (82 percent) also felt that Bank-supported programs help their government focus on policy actions that support the country's medium- and long-term development strategy. Moreover, 77 percent noted that the implementation of policy programs continues even after the completion of Bank operations. However, there is still room for progress: 50 percent felt that the Bank introduced elements that were not part of the country's program, and 40 percent thought the Bank was not sensitive to political constraints. Thirty-seven percent of respondents of the survey said that negotiations with the World Bank significantly modified their original policy program.[46]

2. Predictability of Resource Flows and Performance Orientation

In aid-dependent countries, unpredictable fiscal cash flows can lead to macroeconomic instability or inefficient expenditure allocation and execution.[47] Recent evidence suggests that unforeseen variations of budget aid disbursements in aid-dependent countries remain large, at about 1 percent of GDP, undermining budget planning.[48] Ensuring the predictability of budget support for low-income countries has gained particular relevance in the context of potentially larger aid inflows for achieving the MDGs.[49]

Consultation Feedback on Predictability. Participants in consultations for the conditionality review expressed concerns about the predictability of flows in low-income countries. In the context of developing new approaches to conditionality, one suggestion was to enhance the medium-term predictability of aid by conditioning levels of policy-based aid on a country's overall performance (including fiduciary management) in implementing its program, without tying conditions to specific policy actions.[50] In middle-income countries, external support typically accounts for a much smaller proportion of budget spending. During the consultations for the conditionality review, middle-income countries were less concerned about the exact timing of resource flows but wanted clarity on the conditions to be met in multitranche operations and expected prior actions (or triggers) in programmatic operations.[51]

Bank Approach. The Bank's programmatic approach to policy-based lending—based on a limited set of completed (as opposed to promised) critical actions that reflect country priorities—has contributed to establishing a regular review cycle that is aligned with the country's processes and provides a more predictable, medium-term flow of resources. In low-income countries, the PRSC has helped improve resource predictability; and where early disbursement is critical, the Bank attempts to accelerate the PRSC preparation and negotiation process to improve alignment with the government's domestic timetables.[52] Deeper policy changes to address aspects of medium-term predictability, such as moving from policy actions in individual operations to country-level conditionality through the CAS and CPIA, would involve complex legal, institutional, and operational changes to the Bank's existing framework for appraising and approving policy-based lending.[53]

3. Flexibility and Consistency

In applying conditionality, the Bank uses a considerable degree of flexibility in the judgments it makes: for example, Bank teams can modulate or postpone disbursements of subsequent programmatic operations as a response to underperformance or to an assessment of the adequacy of the macroeconomic policy framework or the overall progress of the program. Similarly, some programmatic loans contain an element of discretion when their triggers are not precisely defined. While there may be an advantage to Bank teams having the flexibility to address concerns about underperformance, undue discretion also carries the risk of uncertainty. The challenge for the Bank is to exercise this discretion consistently and transparently. The Bank and other financial partners have developed a variety of ways to address the issue of excessive flexibility;[54] among them, transparent decision rules and clearly specified triggers can help set out clear expectations of financial partners and recipients and clarify their mutual accountability.

Consultation Feedback on Type of Conditionality and Consistency in Application. During the consultations for the conditionality review, participants expressed broad support for using a series of programmatic operations, with judgments made on overall progress toward medium-term program results rather than on the traditional compliance with ex ante conditions.[55] However, middle-income participants, in particular, suggested that the Bank consider the issue of consistency in making judgments, requesting that an objective way be defined to measure results and compliance with lenders' expectations for future support.

Triggers as a Flexible and Consistent Performance Measure. In programmatic operations, triggers (or expected prior actions) help reconcile the tension between flexibility and discipline in multiyear programs. Triggers allow the Bank to make an overall assessment of whether sufficient progress has been made to move to the subsequent operation. Good practice suggests that triggers should be formulated in a clear and precise manner to be useful as a performance measure, unless the trigger explicitly refers to the outcome of transparently conducted sector reviews.

Graduated Response. In most PRSCs, triggers were converted into prior actions and met before approval of the next operation, indicating that the programs were progressing as intended. Nonetheless, in some cases implementation deviated significantly from expectations (5 percent of triggers were not met at the time of Board approval), and the Bank responded in a graduated manner. In principle, failure to meet triggers could result in a reduction of the commitment amount or a delay in the next operation. Although in most of these instances of missed triggers, the Bank determined that enough progress had been made in other areas to justify moving to the next operation, in some cases lending volumes were reduced or the operation was delayed until corrective measures had been implemented. Finally, a few PRSC-supported programs went entirely off track and the programmatic series was interrupted.[56]

Disclosure and Transparency. The Bank has an exceptional record of transparency. It discloses program documents—which set out the country context, the entire program supported by the operation, the specific conditionality, and the indicative benchmarks and triggers— tranche-release documents, and legal documents for all development operations.[57] Decisions on the loan amount and timing of programmatic operations are transparently reported on the basis of an assessment of progress against specific triggers.

Outcome-Based Conditions. The 2003 Annual Review of Development Effectiveness called for the Bank to "experiment with approaches that would complement intermediate indicators and conditions with indicators of direct poverty reduction results or other outcome-related indicators."[58] During the consultations, there was a rich debate about the potential role for outcome-based conditions, with a universal recognition of the important role of outcome indicators for monitoring and evaluation, to ensure that programs reach their intended results over the medium term. Of particular interest is the emerging experience with an approach of the European Commission to condition variable tranches on service delivery indicators.[59] Linking annual disbursement volumes directly to outcome indicators faces a number of practical challenges, such as unavailability of suitable short-term outcome indicators (e.g., for public finance management and private sector development), substantial time lags in data availability, unreliability of data, and the risk of penalizing governments for outcomes that are outside their control.[60] A formulaic application of outcome-based conditionality could also reduce the flexibility and adaptability of the programmatic approach. Country experience therefore suggests that outcome-based indicators are an essential tool to measure results, but their use as conditions for disbursement should be approached with caution.[61]

B. Improving Coordination with Financial Partners

Harmonization of financial support holds the promise of reduced transaction costs and a reduced burden of conditionality for the recipient country, particularly in aid-dependent low-income countries. However, the size of policy matrices may grow as a variety of financial partners ask the government to reflect their focal areas in a harmonized framework. Hence, as more financial partners participate in the design of a unified program, the number of conditions could increase and the quality and relevance of the substance could suffer. Moreover, bilateral partners' use of political conditionality in unified policy matrices will require careful allocation of oversight responsibility among partners for different areas of the policy matrix, particularly for those, such as the Bank, with Articles of Agreement prohibiting political involvement.[62]

Consultation Feedback on Harmonization and Alignment. All parties agree on the need to encourage development partners, including the Bank, to make further progress in aligning aid with country priorities, harmonizing practices, and reducing transaction costs. Most believe that progress in this respect will take strong leadership by recipient governments. To a large extent, therefore, the question of alignment is associated with strong country ownership and with financial partners' respect for that ownership.

Improving Harmonization and Support for Country-Owned Strategies. It is important to minimize the risk that the conditions used by development partners and the Bank will contradict or impair each other. If there is a clear division of labor among the partners, each partner's approach to conditionality can be effective and can reduce transaction costs. Assigning specific areas to lead partners that have a comparative advantage can help. In low-income countries, the common framework provided by countries' PRSs and annual progress reports become a useful platform around which to facilitate donor coordination and harmonization. The aim is for governments to negotiate a single comprehensive reform program, with lower costs in terms of time and effort, preparation, reporting, and monitoring. The content of all donor programs should be consistent with the PRS priorities and with each other, and streamlined.[63] The challenge for the Bank is to conduct its due diligence and coordinate its conditionality with other development partners, while aligning operation-specific conditionality with the results framework set out in the CAS and retaining its own distinct accountability.

C. Scope and Specificity of the Policy Matrix

The presentation of a country's policy program that is supported by a development policy operation can draw on existing policy matrices if government development strategies are well articulated and prioritized. When this is not the case, policy matrices tend to go well beyond simply listing conditions for disbursement to serve as a reference framework for a subset of government policies supported by the Bank. They also help to spell out implementation steps for achieving program objectives: governments have frequently found it useful to have Bank assistance in operationalizing a more detailed implementation and results framework—particularly when it serves as a vehicle for conducting substantive sector dialogue and addressing cross-sectoral issues.

Length of the Policy Matrix. The average policy matrix—which includes prior actions, triggers, and indicative benchmarks—has grown in length, even though the number of prior actions has fallen.[64] The principal reason seems to be that the sectoral coverage of PRSCs, and therefore the scope of the policy program, typically broadens as the program matures, and thus the number of indicative benchmarks increases. Country authorities themselves may at times prefer to rely on a detailed matrix that helps them implement the sectoral agenda of the PRSP. In countries where several donors are providing budget support, the proliferation of benchmarks has also been driven in part by efforts to include specific donor preferences in a harmonized framework.

Consultation Feedback on Scope of Conditionality. During the consultations for the conditionality review, some stakeholders pointed at the length of the policy matrices in Bank-supported operations, criticizing them as intrusive micromanagement that is inconsistent with national poverty reduction strategies.[65] Others, however, stressed that World Bank conditions, triggers, and benchmarks need to be seen in the wider context of the country's own development program and the conditionality set by other development partners. It was recognized that countries need to focus attention on a few actions that are critical to success, particularly where capacity is weak—and that development partners, including the Bank, should do likewise.

Survey Results on Conditions and Benchmarks. Authorities responding to the survey did not seem to recognize the strong distinction the Bank makes among conditions, triggers, and benchmarks.[66] Seventy-five percent of participants agreed that their countries have to comply with *all* the policy actions in the policy matrix, although 74 percent agreed that the government only needs to meet *selected actions* in the policy matrix, which it had agreed with the Bank to be critical. These seemingly inconsistent responses may be explained in part by the fact that the number of benchmarks varies widely across countries responding to the survey, with fewer in IBRD countries than in IDA countries.[67] Many felt that the size of the policy matrices was determined more by the inclusion of multiple sectors (79 percent) than by collaboration and harmonization among external development partners (38 percent). Borrowers generally agreed (72 percent) that policy matrices include measures complementary to those necessary to achieve the program's outcome, and that in multisector operations the number of actions a government needs to take to obtain financial support increases significantly (77 percent). In addition, 21 percent thought some critical actions were not included in matrices. Finally, respondents saw little difference in the flexibility to obtain formal waivers (in multitranche operations) or adapt triggers (in programmatic operations).

Avoiding Matrix Overload. The clear challenge for the Bank is to avoid overloading the policy matrix. While advice to Bank teams has emphasized the need to focus on a few critical conditions and triggers that are truly essential for the achievement of the program results, teams have had considerably more latitude regarding benchmarks, milestones, and outcome indicators. In addition to further clarifying its approach, the Bank can do better at choosing actions that are critical for achieving the outcomes and thus limiting the proliferation of measures in multisectoral settings.

D. Aligning with Countries' Accountability Frameworks

For greatest aid effectiveness, the monitoring of policy-based support should be aligned around a country's own processes. Experience has shown that when conditionality and results monitoring are based on a country's own accountability arrangements, they can make a substantial contribution toward greater alignment across different dimensions, particularly in countries where budget support represents a significant share of total budgetary resources. In better-performing low-income countries, PRSCs help align the Bank's policy-based financing with other donor budget support programs, and budget support with the government's annual PRS, budget, and planning cycles.[68]

Consultation Feedback on Accountability and Monitoring. During the consultations, participants stressed the need for stronger domestic arrangements for financial management and accountability, transparency, and monitoring of progress and results.[69] Donors providing direct budget support in low-income countries see such improvements as important for reducing their own fiduciary risk—and they, and recipient countries, also see a major payoff in increasing the coherence of countries' budget processes and strengthening budget execution.

Survey Results on Designing and Implementing Programs. Country authorities suggest that the Bank can improve in simplifying the preparation, negotiation, and implementation of programs.[70] The greatest preparation challenges are poverty and social impact analysis (58 percent), prior analytic work (57 percent), and consultations with stakeholders (51 percent), which were identified as more burdensome than fiduciary aspects (30 percent).

Budget and Planning Cycles. Programmatic support is expected to be closely aligned with the government's budget and planning systems and timetables. The aim of facilitating the government's ability to plan and execute the budget could be met by confirming commitment amounts at a time when the government is finalizing the budget, and then disbursing when the resources are needed for program implementation. Governments are particularly interested that the implementation reviews with the Bank (and other financial partners) take place in line with established internal accountability cycles—such as the annual performance review for the PRS or the government's internal reporting cycle during the budget process.

E. Customizing to Country Circumstances

For many development issues and questions there is no single answer; to a large extent, the relevance of any issue and the response to it seems to depend on a country's specific circumstances.[71] The 2003 Annual Review of Development Effectiveness identified strong analytic underpinnings as a major factor contributing to the success of policy programs; nevertheless, it noted that the Bank had not always paid sufficient attention to alternative perspectives or to individual country circumstances, and it said that generic "best practices" should give way to intensified efforts to customize and adapt knowledge to specific localized problems, taking country experience into account.

Variety of Experiences. Much of the debate on conditionality over the past few years—and much of the consultation for the review—has revolved around the notion of regular budget support for well-performing low-income countries.[72] Despite obvious differences, middle-income countries also endorsed many of the concepts and possible best practices that emerged from these debates.[73] However, the approach to conditionality clearly must vary with the circumstances of recipient countries, including their implementation capacity and aid dependency, degree of commitment and reform readiness, effectiveness of resource use, fiduciary framework, macroeconomic stability, and financial vulnerability to crises. In particular, the review singled out the case of development policy lending to fragile states and subnational entities in middle-income countries.

Conditionality in Fragile States. While participants in the consultations agreed that the role for policy-based support in fragile states (also termed low-income countries under stress) is limited, they also recognized that in some cases it can play a critical role. The World Bank and other donors have been providing budget support for poverty reduction and reconstruction in such fragile states as Afghanistan and Timor Leste, and in West Bank/Gaza. In post-conflict transition situations, there are some good examples of the use of policy-based financing to structure donor dialogue on priorities and leverage complementary capacity building.[74] Lessons of good practice in conditionality are emerging from this experience: particularly, the need for the design of conditionality to take into account a broad assessment of progress and the country's limited institutional and implementation capacity. Conditionality can be helpful if it bolsters the government's case for implementing policy measures to which it is already committed, and helps operationalize its strategy. But the imperfect policy analysis of underlying transition programs, the fluctuating policy environment, implementation constraints, and high cost of disbursement delays all call for building flexibility into program design.

Conditionality for Subnational Lending. Some World Bank borrowers have a federal or quasi-federal structure of government, in which states or provinces have legislative and administrative autonomy in various areas and independent budgetary authority, including the right to raise revenues and issue debt.[75] The performance of such state or provincial governments can matter greatly for the country's macroeconomic stability, growth, and poverty reduction.[76] The Bank can provide development policy operations to subnational units in support of state-level programs of fiscal and sectoral policy and institutional actions, if these units have satisfactory fiscal relations with the central government and a sovereign guarantee. General design considerations for conditionality also apply to operations in support of state-level reforms.[77] A specific issue for subnational development policy lending concerns the actions the central government should take to allow the state's program to succeed (e.g., actions to tighten budget constraints for states). Such actions are neither under the control of the state government nor limited to the state that receives the loan proceeds; consequently they should typically be part of the prior actions to be taken before Board presentation of the loan.

V. Key Messages of the Conditionality Review

The conditionality review yielded a few key messages and conclusions regarding the World Bank's use of conditionality.

Operational Policy Framework. The findings of the literature and feedback received during consultations confirm that the Bank has the capacity to apply best practice under the umbrella of its existing operational policy. The operational policy is consistent with a view that conditionality is neither coercion nor inducement to undertake reform, and does not prescribe policy content. OP 8.60, issued in August 2004, includes the principles of country ownership, selectivity in Bank support, strong analytic underpinnings for policy choices, alignment of Bank operations with a country's own development strategy, customization of support to country circumstances in the context of the CAS, criticality of conditions for program results, harmonization of support and conditions, alignment of support cycles with a country's monitoring and evaluation cycles, and transparency of Bank documentation. The operational policy also allows a variety of lending approaches, in line with borrower preferences and needs.

Ownership. In its operational work, the Bank has fully recognized the importance of ownership for development effectiveness—but, like other development partners, it is grappling with the practical challenges of assessing ownership and responding to changing policy environments. To ensure country ownership of Bank-supported programs, the Bank is systematically aligning its CASs with countries' own development strategies.[78] Rather than imposing a burden, conditionality in development policy lending should help measure progress. In addition, the Bank provides analytic work and advice on policy options and recognizes that borrowers require policy space to make their choices and seek the support of stakeholders. Difficulties can arise where ownership issues are blurred, since different groups in government and in the country may support the program to different extents. Generally, the operational policy therefore advises staff to make judgments on the basis of the country's track record. However, further study of political economy considerations and indicators of ownership for Bank operational purposes is typically needed. When the Bank does not see sufficient evidence of ownership, it normally chooses not to engage in development policy lending rather than attempt to substitute conditionality for ownership. Applying selectivity may not always be easy, especially in genuine turnaround cases and fragile states, where the Bank often needs to weigh the risks of engagement carefully against the potential for large impact.

Matrices in Multisectoral Programmatic Operations. The Bank has made important strides in adapting its lending practices to complex reform programs and focusing conditions on critical actions—but as policy matrices in multisectoral programmatic operations grow in size, they are perceived as unduly complex and intrusive. Although the Bank has reduced the number of conditions and moved to programmatic lending operations in which conditionality is based on completed actions, the programmatic support of broad multisectoral government programs—particularly in low-income countries—has given rise to increasing numbers of benchmarks in the policy matrices that describe and operationalize the program supported by the Bank. Although these benchmarks are considered indicative milestones to gauge progress and help manage program implementation, and are not critical actions that could hold up disbursements, there is a perception of Bank intrusiveness, and the potential that capacity in low-income countries may be strained as matrices become more complex.

Balancing Predictability and Performance. The Bank has applied conditionality in a clear and transparent fashion, but it needs to exercise the flexibility of programmatic approaches cautiously to balance predictability with performance. Bank conditionality is generally set out clearly in advance through conditions or anticipated prior actions (triggers) for future support, which are transparently disclosed to a wider public through the Bank's documentation, available on the Bank's external website. However, particularly in programmatic operations, the Bank's approach allows discretion in the design of prior actions and a gradual adjustment of support volumes in response to performance. This flexibility must be applied in a disciplined setting of progress evaluation, or the Bank may be seen as "raising the bar" or announcing support volumes late and forcing borrowers to find alternative financing arrangements. Borrowers need clarity about conditions and level of support at a sufficiently early stage to adjust their budgetary planning. Although the Bank has delivered predictable budget support for well-performing low-income countries through PRSCs, its practice of adjusting development policy lending volumes annually on the basis of performance evaluations has also raised questions by some governments and other financial partners about medium-term predictability.

Balancing Harmonization and Accountability. The Bank's approach is fully supportive of international efforts to harmonize financial support while retaining its own distinct accountability. In the context of harmonization, borrowers are concerned about the expanded or inconsistent conditionality that may be involved in dealing with a large number of development partners, and the consequent transaction costs. While the Bank's governance structure and review processes require separate accountability for making independent assessments, its approach to conditionality encourages harmonization around a unique and coherent set of performance measures in line with the Paris Declaration on Aid Effectiveness and good practice developed by the Development Assistance Committee of the

Organisation for Economic Co-operation and Development.[79] At the same time, to avoid the perception of collusion and diminish the risk of greater aid volatility, some borrowers may prefer "diversifying" the risk of disbursement shortfalls by allowing development partners to disburse against different indicators in the single framework.

VI. Good Practice Principles and Next Steps

The messages emerging from the conditionality review are an important input for disseminating and reinforcing good practice in the Bank's development policy operations. This section suggests a set of good practice principles and describes how they can be introduced and reinforced in the Bank's development policy lending operations.

Supporting Domestic Accountability Mechanisms. A forthcoming review of the poverty reduction strategy approach identifies and discusses in detail how the approach can reinforce domestic accountability mechanisms in low-income countries and help balance them with external accountability.[80] In particular, the PRS review notes the importance of functioning domestic mechanisms to ensure that external accountability frameworks do not overwhelm domestic settings. It also emphasizes the importance for functioning domestic accountability mechanisms of sufficient support for country analytics, monitoring and evaluation, participation, and space for policy dialogue. The good practice principles build on these findings and emphasize how conditionality and approaches of the Bank's policy-based lending can be mindful of striking a balance between internal and external accountability needs.

A. Good Practice Principles

The good practice principles listed below build on the main messages of this review and expand on the foundation laid by the new operational policy for development policy lending, which will continue to guide the Bank's policy-based support.[81] Although these good practice principles are generally applicable across the Bank, they may translate into different forms of engagement depending on country circumstances (Box 1, at the end of this section, describes the Bank's experience in two different countries).

Table 1. Good Practice Principles

Ownership	***Reinforce country ownership.***
Harmonization	***Agree up-front with the government and other financial partners on a coordinated accountability framework.***
Customization	***Customize the accountability framework and modalities of Bank support to country circumstances.***
Criticality	***Choose only actions critical for achieving results as conditions for disbursement.***
Transparency and Predictability	***Conduct transparent progress reviews conducive to predictable and performance-based financial support.***

1. Reinforce Country Ownership

Bank operations and conditionality should actively contribute to broad ownership of the programs, policies, and institutional actions undertaken by the government. To this end, the Bank's development policy lending should support only policies and programs for which there is some clear evidence of ownership. In low-income countries, policies described in a poverty reduction strategy adopted by the government after broad-based consultations typically meet that expectation; in other countries, the Bank may ascertain, for example, that the government's proposed policies and programs gained strong support through an election or parliamentary process. In all cases, evidence of a track record of sound policy implementation strengthens the articulation of government programs.

Assessing Country Ownership. Political economy analysis may give additional insights into the likelihood of a program's success and could be employed both at the CAS level and the level of the individual operation.[82] It may also be necessary for the Bank to allow sufficient time for country processes, such as parliamentary debate, to be completed before the details of Bank support are established. In case the government's own policy agenda is insufficiently owned or weak, the Bank would choose not to provide development policy loans rather than substitute conditionality for ownership.

Supporting Analytics and Capacity Building. Efforts to reinforce ownership need to rely strongly on country-tailored policy and institutional analysis and, as appropriate, enhancement of country leadership capacity. Through the CAS and in consultation with country authorities and other financing partners, the Bank should identify any relevant analytic gaps, which can be filled by the Bank (through analytic and advisory activities and economic and sector work), the country, or third parties. This work should then feed into the country's policy-setting mechanism, such as a PRSP process. Furthermore, if gaps exist the Bank should seek to support the country in building its institutional capacity for leadership in policy formulation, implementation, monitoring, and evaluation—through joint analytic work, or targeted technical assistance and capacity-building operations.

2. Agree Up-front with the Government and other Financial Partners on a Coordinated Accountability Framework

Under the lead of country authorities, Bank staff should reach understandings with the government and other partners on a single and internally coherent framework for measuring progress under the government's program. Typically, such an accountability framework should comprise actions, outputs, and outcome indicators drawn directly from the government's own program over a medium-term period. As appropriate, depending on the type of Bank intervention, the accountability framework could apply to the overall program or to a sector program. In countries with support from a multitude of partners, the accountability framework should be used to foster coherent interventions: all financial partners would support a set of policies that aim at achieving a single set of results agreed under the accountability framework. Typically, harmonized and coordinated support for government policies would include an up-front division of labor, under which the Bank could follow the lead of others in specific areas, as appropriate, but without jeopardizing quality standards. (Box 1 describes the Bank's experience in Mozambique.)

3. Customize the Accountability Framework and Modalities of Bank Support to Country Circumstances

Accountability frameworks should never be used to add policy actions to the government's agenda, or leverage outside preferences; therefore, any agreed accountability framework should be fully consistent with the government's expressed policy intentions and internal accountability mechanisms.[83] Moreover, the detail, size, and frequency of review of progress under government programs should fully reflect country circumstances, such as country capacity and reform readiness. For example, in countries that have already undertaken a substantial reform process, the focus of reviews would typically be on sustained policy implementation rather than new reform actions, and an accountability framework would contain only a few critical steps or indicators to track broadly whether sustained policy implementation is having the intended results. By contrast, if substantial reform efforts are still under way, the accountability framework could reflect a closer tracking of policy actions and results over time and contain a limited set of additional benchmarks relevant to the program.

Modalities and Timing of Support. Modalities and timing of support should respond to country- and program-specific needs. The choice of lending design—whether the Bank engages through single or multiple tranches, in a programmatic or short-term fashion, in a broad or focused manner, or on a national or subnational level—should reflect country preferences and needs. Policy-based support in fragile states requires particular attention to their particular country circumstances and institutional capacity. The Bank's support for sensitive policy reforms (such as privatization, trade liberalization, and user fees) should be based on an understanding of the country-specific political economy of reform and may be warranted when such reforms are part of a well-designed and broadly owned government strategy. Similarly, the timing of Bank operations should be aligned with the country's financing requirements and its internal approval processes, such as the budget session of parliament.

4. Choose Only Actions Critical for Achieving Results as Conditions for Disbursement

In establishing the conditions for lending, Bank and country staff should choose, from the agreed accountability framework, policy and institutional actions that are critical for achieving the results of the program and are aligned with the CAS results framework. These actions could serve as prior actions for single-tranche operations, conditions for tranche releases under multitranche operations, or indicative prior actions (or "triggers") for follow-on operations in a programmatic support framework. Triggers in programmatic operations should be clearly marked and identified to country authorities and in Board documents. The flexibility gained by specifying only indicative prior actions ("triggers") should be used neither to introduce unexpected new disbursement conditions nor to lower performance standards. If the government agrees, triggers can, if necessary, be modified or replaced with alternative prior actions to achieve the intended results. However, this change should not be used to "leverage" other reform areas by adding new conditions from within or outside the accountability framework. For example, the benchmarks contained in many policy matrices to describe the broader policy program should generally not be used as additional prior actions for disbursements of subsequent loans. At the same time, once an area has been identified as critical through the choice of a trigger, the Bank should clearly indicate in follow-on operations how the intended results are being achieved, even if sometimes the original actions have been modified to reflect changes on the ground.

Presentation of Program. Bank operational documents should rely to the extent possible on the government's existing presentation of programs and policies. If the agreed accountability framework coherently sets out actions, outputs, and outcomes for the government program, there is no need to include more than a few conditions and triggers, as well as a set of related results indicators, in the Bank's Board documentation. These conditions or triggers and results indicators would identify how the Bank follows progress under the program and clearly set out expectations of the Bank for making resources available. Results indicators would also serve as tools to evaluate to what extent Bank operations achieve their intended development outcomes, and they should be equivalent to those reflected in results-based CASs. The accountability framework—that is a set of actions, outputs, and outcomes—could be used as an attachment to the Letter of Development Policy (LDP) to define government intentions under the program, and the text of the LDP could become a short and focused summary statement of policy intentions that cross-references the accountability framework. In this case, there would be no need for including a separate "Bank policy matrix" in program documents.

Outcome Indicators. Outcome indicators are important for measuring results. For Bank operations, output and outcome indicators, with clear baselines and targets, should be included in performance frameworks as key instruments to measure results under the government's program and monitored closely. Selected indicators from the performance framework could also serve to measure results in the Bank's CAS and lending operations. However, they should be used only cautiously as disbursement conditions or indicative prior actions. To serve as conditions or indicative prior actions for Bank disbursements, indicators would need to be reasonably responsive to government actions within a short timeframe and able to be measured with satisfactory timeliness and accuracy.[84] A few service delivery indicators in the social sectors may meet these criteria (such as "vaccination rate" or "primary completion rate"), but generally institutional reforms, notably in public financial management, are less amenable to such an approach.

5. *Conduct Transparent Progress Reviews Conducive to Predictable and Performance-based Financial Support*

In the context of medium-term Bank support, progress should be reviewed regularly and in line with a country's monitoring and evaluation cycle. In many countries, such reviews take place in the context of the budget preparation or the preparation of annual PRS progress reports; and the review may build on several staggered sectoral review processes. To the extent possible, the government's own internal accountability processes (e.g., required reporting to parliament) and reporting systems and monitoring frameworks should be used to meet the Bank's and others' information needs. In addition, the Bank should actively encourage governments to strengthen their own internal accountability mechanisms and monitoring systems. Transaction costs of reviews should be minimized through harmonized reviews with other interested partners, reducing the number of individual requests for information. On the basis of the review of progress, which should draw on implementation of triggers and conditions, and an evaluation of the overall advancement toward anticipated results, the Bank should adjust financing levels to performance. In this regard, recent experience with graduated responses under PRSCs (see paragraph on Graduated Response, p. 17) offers useful lessons o staff on modulation of financial support. Moreover, any financial support decisions should be announced sufficiently early to be taken into account in the country's own decisionmaking and budget allocation processes.

Results Management and Measurement. Performance reviews should actively promote a culture of results management and measurement. Using the policy actions and indicators in the accountability framework as basis, the performance reviews should not only report on policy implementation and progress made, but also foster analysis and feedback on improving the impact of government policies.

Box 1. Good Practice in Different Country Circumstances

A. Low-Income Country: Mozambique

In Mozambique, the Bank is engaged in a series of programmatic development policy credits and grants, including a poverty reduction support credit. Mozambique adopted a PRSP in 2001 and has prepared annual updates of the government's implementation plan for the PRSP, a retrospective on PRSP implementation, and a budget implementation report. The preparation of these reports is closely aligned with the government's own budget cycle and internal accountability process. Drawing on these documents, in 2004 the government began to agree annually with a group of donors (numbering 17 in 2005) on a maximum of 50 actions and results indicators in a performance assessment framework (PAF). Progress made under the PAF is reviewed twice a year, in April-May and September-October, with the first review focusing on achievements in the previous year, and the second on midyear implementation and the draft budget for the following year. Donors use the April-May review to announce financial support for the following fiscal year (starting in January), and each donor can modulate or withhold support based on this evaluation of performance. Proposed donor financing is firmed up in September-October once the final budget for the following year has been presented, and, in the Bank's case, the Board has approved the loan. The Bank has aligned disbursement conditions and triggers for future PRSC support with the PAF, drawing a set of six to eight measures from this internally coherent framework. Moreover, over the next 12 months, the Bank will align its internal review, Board decision, and disbursement cycle with the PAF review cycle.

B. Middle-Income Country: El Salvador

The Salvadoran government, elected on the basis of a strong electoral platform, requested Bank support for its agenda in the form of a series of programmatic development policy loans under the 2005-08 CAS. A first development policy loan was approved in early 2005 on the basis of the strong policy actions the government had already taken toward trade integration and competitiveness, fiscal reform, and governance. Discussions with the government identified an additional set of 10 follow-on actions in these areas as key progress indicators for future support. In addition, the government identified its targets for results indicators in these policy areas for the CAS, which were also reflected as expected results of the development policy loan. The Bank intends to align its review of progress under the series with the parliamentary budget approval cycle to permit ratification of future loans in conjunction with future budgets. The close link of the intended reforms with the country's growth potential and fiscal performance also implies that the Bank's assessment of creditworthiness and thus the overall volume of future fast-disbursing lending during the CAS period are tied to progress made under the program.

B. Next Steps: Implementing the Principles

Following the Development Committee meeting in September 2005, the Bank will focus on disseminating the findings of the conditionality review and implementing the good practice principles.

Communication. The Bank will use interaction of Bank operational staff and country offices with borrowers, as well as international fora and workshops with other development partners, to share its findings of the review. This would involve:

- Better and clearer communication to partner countries of the Bank's approach to policy-based lending, particularly the design features of programmatic lending and the distinction between prior actions, triggers, tranche-release conditions, and benchmarks.
- More detailed feedback from borrowers and follow-up on issues identified by the survey (e.g., complexity of operations, thematic coverage of policy-based lending).
- Continued and reinforced dissemination to the wider public of the Bank's shift to development policy lending and its approach to conditionality.
- Continued close exchanges of country experiences and research findings on the application of conditionality with the IMF, multilateral development banks, and other development partners.

Implementation of the Good Practice Principles. The good practice principles of ownership, harmonization, customization, criticality, transparency, and predictability will have to stand the test of practical challenges in Bank-supported operations on a day-to-day basis. It can be expected that their full implementation is likely to contribute to reduce the challenges and tensions inherent in conditionality, yet without fully eliminating them. Bank Management will use guidance notes, training events, and the corporate review process on specific operations to advise teams on the consistent implementation of the good practice principles and dissemination of best practices. In particular, this could include:

- Guidance for reinforcing exchange of view with parliaments and other stakeholders, strengthening political economy analysis in the context of overall analytic work, and balancing selectivity with ownership in development policy operations.

- Advising governments and teams on the principles for the design of focused accountability frameworks, in particular on the disciplined and coherent use of actions and indicators, and their grounding in domestic documentation and processes to the extent possible.

- Sharing emerging international experiences on good practices for national processes to develop accountability frameworks under government leadership.

- Feedback on the choice and documentation of critical conditions and triggers and results indicators from accountability frameworks, with a focus on aligning program outcomes to the CAS results framework.

- Reminders on a more disciplined use of benchmarks in future Bank operations, particularly those with a multisectoral design and extensive donor coordination.

- Guidance on appropriate presentation in program documents of accountability frameworks and the respective actions and indicators.

- Guidance on the expectations for outcomes of progress reviews under accountability frameworks, and their effective use in Bank operations.

Review of Development Policy Lending. A review of development policy lending will be undertaken during FY07. It will take stock of the implementation of the good practice principles and update trends in conditionality. The paper will serve as an input to the midterm review of IDA14.

EXTERNAL CONSULTATIONS FOR CONDITIONALITY REVIEW

Date	*Location*	*Host*	*Objective*	*Participants*
12/2004	London	DFID UK	Feedback on concept of review	Donors, academics, aid agencies, and civil society organizations
01/2005	London	ODI/LICUS conference	Discuss conditionality in fragile states	Recipient governments, academics, donors, and NGOs
02/2005	Video-conference	World Bank	Discuss practice of conditionality with MDBs	Multilateral development banks
02/2005	Paris	World Bank	Consultation with CSOs	CSO representatives from developed and developing countries
04/2005	Berlin	BMZ/InWent Germany	Consultation with selected borrowers and donors	Borrowing countries, NGOs from those countries, and aid agencies
04/2005	Washington	World Bank Spring Meetings	Consultation with LICs	Governments and parliamentarians of LICs
04/2005	Washington	World Bank Spring Meetings	Consultation with CSOs	CSO representatives from developed and developing countries
05/2005	Cape Town	World Bank/SPA	Exchanges on best practices in budget support	IDA borrowing countries, academics, and aid agencies
06/2005	Washington	World Bank	Consultation with MICs	Governments of MICs, MDBs
01 to 06/2005	Bank Website	Open consultation	Open forum for the review	General public
05/2005	Internet	Independent consultant	Survey of country authorities' views on conditionality	High-level government officials from countries that have had policy-based loans, FY00-05

ANALYTIC WORK FOR CONDITIONALITY REVIEW

Contribution	*Reference*	*Date*	*Objective*
Issues Paper	CODE2005-0002	01/19/2005	Set out concept of conditionality review
Conditionality Revisited	ISBN 0-8213-6013-2	04/2005	Compilation of articles on conditionality
PRSC Retrospective	IDA/SecM2005-0238	05/26/2005	Review experience with PRSCs
Conditionality in Fragile States	SecM2005-0353	06/2005	Good practice note on development policy operations in fragile states
Budget Support Groups and Joint Financing Arrangements	SecM2005-0361	06/2005	Good practice note on operating principles of budget support groups
Results in Development Policy Lending	SecM2005-0365	06/2005	Good practice note on achieving a results-orientation in development policy operations
Subnational DPL	SecM2005-0390/8	06/2005	Good practice note on subnational development policy lending
Progress Report to CODE	CODE/A2005-0015	06/24/2005	Present preliminary progress of conditionality review
Trends in Policy-Based Lending	SecM2005-0390/4	07/21/2005	Update of trends in numbers and content of conditionality, including aggregate Bank-Fund conditionality
Modalities of Bank Conditionality	SecM2005-0390/1	07/21/2005	Rationale and principal forms of conditionality
Summary of Consultations	SecM2005-0390/6	07/21/2005	Including selected borrowers from fragile states, low-income countries, and middle-income countries
Content of Conditionality	SecM2005-0390/	07/21/2005	Evolution of content of conditionality
Summary of Conditionality Survey	SecM2005-0390/3	07/21/2005	Summary findings of survey sent to authorities of borrowing countries
Legal Aspects of Conditionality	SecM2005-0390/2	07/21/2005	Legal aspects relating to the policy and practice of conditionality
Literature Review	SecM2005-0390/7	07/21/2005	Review of recent analytic contributions in the literature and its recommendations
Conditionality Review: Summary Findings	SecM2005-0390	07/21/2005	Conclusions of conditionality review and draft good practice principles

NOTES

[1] Policy-based lending denotes financial support through loans or grants given by the World Bank in the form of the now-retired adjustment lending and development policy lending.

[2] *Development Committee Communiqué,* October 2, 2004.

[3] *World Bank,* From Adjustment Lending to Development Policy Lending: Update of World Bank Policy *(R2004-0135), OPCS, July 15, 2004.*

[4] World Bank, *Review of World Bank Conditionality: The Theory and Practice of Conditionality: A Literature Review* (SecM2005-0390/7), DEC, July 2005.

[5] World Bank, *Review of World Bank Conditionality: Recent Trends and Practices* (SecM2005-0390/4), OPCS, July 2005.

[6] *Development Committee Communiqué,* Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries, October 2, 2004, para 7.

[7] Policy-based lending is used here to denote financial support through loans or grants given by the World Bank in the form of the now-retired adjustment lending (under OD 8.60) and development policy lending (since the introduction of OP/BP 8.60 in September 2004).

[8] See *World Bank and IMF, Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality* (World Bank SecM2001-0461/1 and IMF SM/01/219), August 24 and 23, 2001, respectively; *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality—Progress Report* (World Bank SecM2002-443 and IMF SM/02/271), August 2002; and World Bank and IMF, *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality—Second Progress Report* (World Bank SecM2004-0070 and IMF SM/04/57), February 24, 2004. The next review of Bank-Fund collaboration is expected for FY07.

[9] This review was discussed by the IMF's Board in March 2005 and the International Monetary and Financial Committee at the Spring Meetings 2005; see IMF, *Review of the 2002 Conditionality Guidelines,* March 2005.

[10] World Bank, *Review of World Bank Conditionality: The Theory and Practice of Conditionality: A Literature Review* (SecM2005-0390/7), DEC, July 2005; *Partnerships for poverty reduction: rethinking conditionality,* Department for International Development, Foreign and Commonwealth Office, and HM Treasury, London, March 2005; *Post-Washington Consensus: A Few Thoughts,* Discourse Discussion paper 004/2004, Bundesministerium fuer wirtschaftliche Zusammenarbeit und Entwicklung (BMZ), Berlin, May 2004, *Nordic-Baltic Position Paper: World Bank Conditionality Review,* May 2005. Submissions to World Bank Review of Conditionality by Oxfam International, Christian Aid, EURODAD, and Action Aid, June, 2005.

[11] This paper reflects the input and suggestions by the World Bank's Executive Directors in a meeting of the Committee on Development Effectiveness held on June 29, 2005, an informal meeting of the Board on July 21, 2005 and the Committee of the Whole on September 1, 2005. See World Bank, *Review of World Bank Conditionality: Issues Note* (CODE2005-0002) January 10, 2005; *Summary Findings* (SecM2005-0390) June 30, 2005; *Progress Report to CODE* (CODE2005-0054), June 29, 2005; and *Review of World Bank Conditionality* (SecM2005-0442), August 18, 2005. The background papers are publicly available at the World Bank's external website (www.worldbank.org/conditionality).

[12] World Bank, *Review of World Bank Conditionality: The Theory and Practice of Conditionality-A Literature Review* (SecM2005-0390/7), DEC, July 2005.

[13] World Bank, *Review of World Bank Conditionality: Modalities of Conditionality* (SecM2005-0390/1), OPCS, July 2005.

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

[15] OP 8.60, *Development Policy Lending,* para. 3.

[16] World Bank, *Review of World Bank Conditionality: Legal Aspects of Conditionality in Policy-Based Lending,* (SecM2005-0390/2), Legal Department, July 2005, para. 9.

[17] See OP 8.60, *Development Policy Lending,* para. 14.

[18] OP 8.60 requires that stand-alone single-tranche operations be embedded in a medium-term framework; see para. 14.

[19] World Bank, *Programmatic Adjustment Lending Retrospective,* Report 26315, July 11, 2003.

[20] See the guidance note *Disciplined Use of Conditionality in Lending Operations* issued to World Bank staff by OPCS on September 13, 2004.

[21] See J. E. Stiglitz, *Towards a New Paradigm for Development,* 1998 Prebisch Lecture at UNCTAD, 1998; and J. D. Wolfensohn, *A Proposal for a Comprehensive Development Framework,* Speech, World Bank, Washington, D.C., 1999.

[22] World Bank, *From Adjustment Lending to Development Policy Lending: Update of World Bank Policy* (R2004-0135), OPCS, July 15, 2004.

[23] World Bank*, Programmatic Adjustment Lending Retrospective* (Report 26315), OPCS, July 2003.

[24] See OP8.60, *Development Policy Lending,* para.14.

[25] Experience with the programmatic approach to date suggests that it has been robust and effective in a wide range of country circumstances, largely because of the design features that provided sufficient flexibility to facilitate a stronger focus on results, participation, and harmonization; see World Bank, *Programmatic Adjustment Lending Retrospective* (Report 26315) OPCS, July 11, 2003.

[26] World Bank*, Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238) OPCS, May 26, 2005.

[27] World Bank, From *Adjustment Lending to Development Policy Lending: Update of World Bank Policy* (R2004-0135), OPCS, July 15, 2004.

[28] Conditions here include prior actions preceding Board presentation, effectiveness conditions, and conditions for tranche release, which are set out in the Bank's legal agreements.

[29] World Bank, *Review of World Bank Conditionality: Recent Trends and Practices* (SecM2005-0390/4), OPCS, July 2005.

[30] World Bank, *Review of World Bank Conditionality: Recent Trends and Practices* (SecM2005-0390/4), OPCS, July 2005.

[31] See World Bank and IMF, *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality* (World Bank SecM2001-0461/1 and IMF SM/01/219), August 24 and 23, 2001, respectively.

[32] See IMF, *Streamlining Structural Conditionality: Review of Initial Experience*, July 2001; and IMF*, Review of the 2002 Conditionality Guidelines,* March 2005.

[33] In view of the methodological difficulties in comparing conditionality of the two institutions and the small sample, these results should be interpreted with some caution. For the Bank, the numbers differ little from previously reported figures of conditions per operation.

[34] World Bank, *Economic Growth in the 1990s: Learning from a Decade of Reform*, 2005.

[35] John Nellis, and Sunita Kikeri, "Privatization in Competitive Sectors: The Record to Date" (June 2002)*, World Bank Policy Research Working Paper No.* 2860; and A. Winters, N. McCulloch, and A. McKay, "Trade Liberalization and Poverty: The Evidence So Far*," Journal of Economic Literature,* Vol. 42, No. 1 (2004).

[36] D. Rodrik, "What Do We Learn from Country Narratives?" in: *In Search of Prosperity,* Princeton, N.J..: Princeton University Press, 2003.

[37] World Bank, *Review of World Bank Conditionality: Content of Conditionality in World Bank Policy-Based Operations* (SecM2005-0390/5) PREM, July 2005.

[38] World Bank, *Review of World Bank Conditionality: Recent Trends and* Practices (SecM2005-0390/4), OPCS, July 2005.

[39] World Bank*, Review of World Bank Conditionality: 2005 Conditionality Survey* (SecM0390/3) July 2005. *These figures suggest that, although borrowers' overall evaluations of development outcomes are in line with OED's findings, survey results suggest that improvements could be made in linking Bank activities directly to poverty reduction.*

[40] See, for example, World Bank, *Assessing Aid: What Works, What Doesn't, and Why,* Washington, D.C., 1998; D. Dollar, and J. Svensson, *What Explains the Success or Failure of Structural Adjustment Programs?* World Bank Development Research Group, 1998; and S Devarajan, D. Dollar, and T. Holmgren, *Aid and Reform in Africa,* World Bank, Washington, D.C., 2001.

[41] World Bank, *Assessing Aid: What Works, What Doesn't, and Why,* 1998, p.4.

[42] OP 8.60, *Development Policy Lending,* August 2004, para 3.

[43] For a discussion of conceptual frameworks for assessing ownership, see World Bank, *Adjustment Lending Retrospective,* Report 22723, June 15, 2001, p.73; see also J. Johnson and S. Wasty, *Borrower Ownership of Adjustment Programs and the Political Economy of Reform,* World Bank Discussion Paper No. 4, Washington D.C., World Bank, 1986; and World Bank, *An Operational Approach to Assessing Country Ownership of Poverty Reduction Strategies,* OPCS, February 2005.

[44] World Bank, *Review of World Bank Conditionality: Summary of External Consultations* (SecM2005-0390/6) OPCS, June 2005.

[45] World Bank, *Review of World Bank Conditionality: 2005 Conditionality Survey* (SecM0390/3) July 2005.

[46] A recent survey of 15 African countries finds that depending on the policy area, 20-30 percent of conditions were not literally drawn from the PRS but consisted of measures that were either drawn from other government documents or were considered broadly consistent with the PRS. See *Survey of the Alignment of Budget Support and Balance of Payments Support with National PRS Processes.* Report of the co-chairs of the SPA Budget Support Working Group, Brussels and London, February 2005.
[47] A. Bulir and J. Hamann, "Aid Volatility, an Empirical Assessment," *IMF Staff Papers,* Vol. 50 No. 1 (2003).
[48] O. Celasun, and J. Walliser, *Predictability of Budget Aid: Recent Experiences,* World Bank, 2005.
[49] S. Koeberle, and Z. Stavreski, *Budget Support: Concept and Issues,* World Bank, 2005.
[50] *Partnerships for Poverty Reduction: Rethinking Conditionality,* Department for International Development, Foreign and Commonwealth Office, and HM Treasury, London, March 2005. B. Eifert, and A. Gelb (*Improving the Dynamics of Aid: Towards More Predictable Budget Support,* World Bank, 2005) examine the costs of potential aid misallocations arising for IDA from a move to CPIA-based development policy lending volumes.
[51] World Bank, *Review of World Bank Conditionality: Summary of External Consultations* (SecM2005-0390/6) OPCS, June 2005.
[52] World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), OPCS, May 26, 2005.
[53] Such a change could imply, for example, that (a) the CAS become a Board-approved document allocating resources over a 3-4 year period based on CPIA scores or creditworthiness criteria; (b) a larger part of financing be delivered as fast-disbursing operations; (c) the Board drop its prerogative to review individual lending operations during the CAS period; and (d) annual disbursements be automatic, absent major changes in policy implementation.
[54] World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), OPCS, May 26, 2005.
[55] World Bank, *Review of World Bank Conditionality: Summary of External Consultations* (SecM2005-0390/6) OPCS, June 2005.
[56] World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), OPCS, May 26, 2005.
[57] The Bank's operational policy for disclosing program documents and tranche-release documents of development policy loans is specified in OP 8.60, paras. 29 and 31, respectively. Disclosure of legal documentation after loan effectiveness is described in the World Bank's Disclosure Policy, para. 72.
[58] World Bank, *2003 Annual Review of Development Effectiveness: The Effectiveness of Bank Support for Policy Reform,* OED, 2004.
[59] *European Commission,* EC Budget Support: An Innovative Approach to Conditionality*, February 2005.*
[60] World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), OPCS, May 26, 2005.
[61] World Bank, *Review of World Bank Conditionality: Modalities of Conditionality* (SecM2005-0390/1), OPCS, June 2005; and World Bank*, Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), OPCS, May 26, 2005.
[62] IBRD Articles of Agreement, Article 4, Section 10; and IDA Articles of Agreement, Article 5, Section 6.
[63] In a number of countries, budget-support donors have signed formal Memoranda of Understandings (MOUs) with the government and donor partners to clarify the rules of the game (including mechanisms for the resolution of differences). See World Bank, *Good Practice Note on Development Policy Lending: Budget Support Groups and Joint Financing Arrangements,* OPCS, June 2005.
[64] World Bank, *Review of World Bank Conditionality: Recent Trends and Practices* (SecM2005-0390/4), OPCS, July 2005.
[65] World Bank, *Review of World Bank Conditionality: Summary of External Consultations* (SecM2005-0390/6) OPCS, June 2005.
[66] World Bank, *Review of World Bank Conditionality: 2005 Conditionality Survey* (SecM0390/3), July 2005.
[67] Thirty-three percent of survey respondents were from core IDA countries and 14 percent were from Africa, where most PRSCs are being implemented.
[68] World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238) OPCS, May 26, 2005.
[69] World Bank, *Review of World Bank Conditionality: Summary of External* Consultations (SecM2005-0390/6) OPCS, June 2005.
[70] World Bank, *Review of World Bank Conditionality: 2005 Conditionality Survey* (SecM0390/3), July 2005.
[71] World Bank, *Economic Growth in the 1990s: Learning from a Decade of Reform,* 2005.
[72] S. Koeberle, and Z. Stavreski, *Budget Support: Concept and Issues,* World Bank, 2005.
[73] World Bank, *Review of World Bank Conditionality: Summary of External* Consultations (SecM2005-0390/6) OPCS, June 2005.

74 World Bank, *Good Practice Note on Development Policy Operations and Program Conditionality in Fragile States* (SecM2005-0353), OPCS, June 2005.

75 This includes most of the Bank's large borrowers: Argentina, Brazil, India, Mexico, Pakistan, and Russia.

76 In India, for example, state-level deficits account for almost half of the consolidated fiscal deficit, and achieving country-wide objectives relies on significant policy and institutional reforms on the state level.

77 World Bank, *Good Practice Note on Development Policy Lending: Subnational Lending* (SecM2005-0390/8) OPCS, June 2005.

78 In IDA countries, all CASs are now based on the PRSP. See World Bank*, Results Focus in Country Assistance Strategies: A Stocktaking of Results-Based CASs* (R2005-0042), OPCS, February 24, 2005.

79 *Harmonising Donor Practices for Effective Aid Delivery, Volume 2: Budget Support, Sector-wide Approaches and Capacity Development in Public Financial Management,* Organisation for Economic Co-operation and Development (OECD), Paris, 2005.

80 World Bank and IMF, *2005 Review of the Poverty Reduction Approach: Balancing Accountabilities and Scaling Up Results*, forthcoming.

81 World Bank, From *Adjustment Lending to Development Policy Lending: Update of World Bank Policy* (R2004-0135), July 15, 2004.

82 For a set of indicators to gauge the ownership of poverty reduction strategies, see World Bank*, An Operational Approach to Assessing Country Ownership of Poverty Reduction Strategies,* OPCS, February 2005.

83 As noted above, under OP 8.60 development policy lending is only extended to countries with sufficiently strong programs. For example, a country would be expected to address identified fiduciary weaknesses under its own program.

84 For a variety of concerns hampering the use of indicators as disbursement condition, see Box 9 in World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), June 24, 2005.

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Background Paper 1

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Operations Policy and Country Services
World Bank

Abbreviations and Acronyms

BP	Bank Procedure
CAS	Country Assistance Strategy
DPL	Development policy lending
EC	European Commission
ESW	Economic and sector work
HIPC	Heavily Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
LEG	Legal Vice Presidency
OD	Operational Directive
OP	Operational Policy
OPCS	Operational Policy and Country Services
PIN	Public Information Notice
PRSC	Poverty reduction support credit
TRD	Tranche Release Document

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REVIEW OF WORLD BANK CONDITIONALITY: MODALITIES OF CONDITIONALITY

CONTENTS

REVIEW OF WORLD BANK CONDITIONALITY: MODALITIES OF CONDITIONALITY

EXECUTIVE SUMMARY

1. This paper is one of the background papers of the World Bank's review of conditionality, undertaken in response to the Development Committee's October 2004 request. The purpose of the paper is to provide an overview of the Bank's understanding and application of conditionality in policy-based lending, including its rationale, definition, context, and different types of conditions.

2. ***Rationale.*** The rationale for conditionality is the Bank's due diligence obligation to ensure that its resources are used effectively and responsibly by the borrowing country.

3. ***Definition.*** Conditionality is the set of conditions that, in line with the World Bank's Operational Policy (OP) 8.60, *Development Policy Lending*, can affect the flow of resources to a country. The Bank conditions disbursements in a development policy loan on a positive assessment in three areas: (a) compliance with the critical program conditions, (b) the adequacy of the macroeconomic policy framework, and (c) the overall satisfactory implementation of the program.

4. ***Context.*** The Bank's support to a member country through development policy lending takes place within an overall context that determines the eligibility and the terms for this kind of support. The elements of the context include (a) the country's own development vision and policy, (b) the Bank's strategy for helping the country realize its own vision and policy, and (c) a set of considerations defined by operational policy.

5. ***Modalities.*** Program conditions can be prior actions, floating tranche conditions, regular tranche conditions, or effectiveness conditions. Traditional multitranche operations have increasingly given way to programmatic operations, which consist of a series of single-tranche operations under a medium-term framework. Decisions to move from one programmatic operation to another are made on the basis of an assessment of progress against triggers, which are not formal conditions but expected prior actions of the next operation in the programmatic series.

6. ***Criticality.*** The Bank's policy calls for including as program conditions only those actions of the country's program that are critical for the attainment of the expected results of the program. Identifying critical actions entails having a clear picture of the expected results and the corresponding causal chain that links actions to these results. The recommendations provided to Bank staff have also stressed the importance of keeping the number of conditions low and focused on actions that are specific and monitorable.

7. ***Assessment of Macroeconomic Policy Framework.*** It is the responsibility of the Bank to make its own judgment on the adequacy of the macroeconomic policy framework within its accountability framework. The presence of an appropriate IMF program is usually an important input but not a requirement, except when the special

DPL option is used. The Bank staff ascertain, before making their own assessment, whether the IMF has any major outstanding concerns about the adequacy of the country's macroeconomic policies. Any outstanding issues raised by the IMF are communicated to Executive Directors through the Fund Relations Note, which is a standard annex to program documents.

8. ***Assessing Program Implementation.*** Operational policy conditions development policy lending on the country implementing the overall program in a matter satisfactory to the Bank. Policy matrices are an input to this evaluation. Aside from the critical conditions and the triggers, policy matrices include a significant number of benchmarks and some outcome indicators. These benchmarks are complementary to the conditions and triggers and give a sense of the general direction of the program.

9. ***Benchmarks.*** In contrast to conditions or triggers, benchmarks in program matrices serve as a management tool to describe the contents and results of the government's program in areas monitored by the Bank. Benchmarks therefore do not need to meet the criticality test applied to conditions and triggers. Instead, they have frequently been used to describe small steps in a reform process (such as the preparation of studies and action plans) that represent significant, though not necessarily critical, progress markers for the implementation of the program. They are not legal conditions for disbursements of Bank loans or grants and are not intended to become prior actions for future support. However, they are sometimes perceived as closely related to Bank conditions as they define an area of the Bank's policy involvement and are used as an input to gauge overall program implementation.

10. ***Overall Approach and Challenges.*** The Bank's operational policy for development policy lending provides a robust framework that is consistent with the view that conditionality supports, but does not induce, policy reform. The Bank's approach to conditionality is especially suited to taking into account the particular characteristics and circumstances of a recipient country, allowing the Bank to calibrate the recourse to critical conditions and benchmarks in line with the country's own institutional capacity. Challenges in applying the Bank's approach include the following:

- The Bank's flexibility in its approach entails a certain degree of discretion, particularly when deciding to move from one programmatic operation to the next or assessing the macroeconomic policy framework or the progress of the overall program. The challenge for the Bank is to exercise this discretion judiciously, consistently, and transparently.

- While advice to teams emphasizes the need to focus on a few critical conditions and triggers, teams have had considerable latitude regarding benchmarks and outcome indicators. Some stakeholders have pointed at the length of the resulting matrices. The challenge for the Bank is to avoid overloading the matrices, while focusing on steps that are critical for the results of the program.

- If the results focus of the operation is not adequately linked to the outcomes targeted in the Country Assistance Strategy (CAS), the Bank's approach to conditionality loses effectiveness and its results orientation. The challenge for the Bank is to keep the results focus of the programs aligned with CAS outcomes.

- While the Bank's approach is fully supportive of donor coordination of conditionality to reduce transaction costs for the borrower, the challenge for the Bank is to conduct its due diligence while retaining its own distinct accountability for making independent assessments.

Review of World Bank Conditionality: Modalities of Conditionality

I. Introduction

1. This paper is undertaken in response to a request by the Development Committee in October 2004.[1] The objective of the review is to take stock of the Bank's current practice with respect to conditionality, identify the challenges in implementation, and outline good practice applications.

2. ***Framework for Review.*** The Issues Note of the review of conditionality defined a work program that included a number of consultations with stakeholders and analytic work that would serve as background to the paper that will be sent to the Development Committee for consideration and discussion.[2] The purpose of the paper is to provide an overview of the Bank's understanding and application of conditionality in policy-based lending, including its rationale, definition, context, and different types of conditions.

3. ***Structure of the Paper.*** Following this introduction, Section II explores the concept and rationale of conditionality in the Bank's policy-based lending. Section III looks at the framework that guides the Bank's financing made available through policy-based lending and describes the context for conditionality. Section VI examines the different approaches through which the Bank provides policy-based lending and the role of conditionality. Section V concludes with issues and possible areas for strengthening the Bank's modalities within the existing operational policy framework.

II. Concept and Rationale of Conditionality

4. Conditionality is involved whenever the flow of resources from the Bank can be halted in case the recipient country does not meet certain conditions.[3] Operational Policy (OP) 8.60, *Development Policy Lending*, states: "The Bank determines which of the agreed policy and institutional actions by the country are critical for the implementation and expected results of the program supported by the development policy loan. The Bank makes the loan funds available to the borrower upon maintenance of an adequate macroeconomic policy framework, implementation of the overall program in a manner satisfactory to the Bank, and compliance with these critical program conditions."[4] Accordingly, at the program level, the Bank's decision to provide assistance to the borrowing country is conditional on (a) the Bank's judgment about compliance with the critical program conditions, (b) the adequacy of the macroeconomic policy framework,

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[1] Paragraph 7, Development Committee Communiqué*, Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries,* October 2, 2004. The Committee asked the Bank to "review its own policy and practice on conditionality" and "report on the continued efforts by the Bank and the Fund to streamline their aggregate conditionality."

[2] World Bank, *Review of World Bank Conditionality: Issues Note* (CODE2005-0002), January 10, 2005.

[3] Paragraph 5, *Review of World Bank Conditionality: Issues Note* (CODE2005-0002), January 10, 2005.

[4] Para 13, OP 8.60.

and (c) the overall satisfactory implementation of the program. These three elements constitute the Bank's conditionality.

5. ***Rationale.*** The World Bank uses conditionality to provide assurances that its limited resources are used effectively and responsibly, helping borrowing countries to grow and reduce poverty. The Bank is required by the Articles of Agreement of both IBRD and IDA to carry out due diligence and ensure that all acts are guided by their respective institutional purposes.[5] Accordingly, the Bank seeks to be as effective as possible when providing assistance to a member country, in line with the country's own developmental priorities and economic efficiency. The Bank also seeks to ensure that the country uses the assistance responsibly from a fiduciary and a financial perspective. Thus, when the Bank conditions the release of funds, it is carrying out its due diligence on development effectiveness and financial and fiduciary responsibilities.

III. Context for Conditionality

6. The Bank's support to a member country through development policy lending (DPL) takes place within an overall context that determines the eligibility and the terms for this kind of support. These elements include (a) the country's own medium- or long-term development vision and policy, (b) the Bank's strategy for helping the country realize its own vision and policy, and (c) a set of considerations defined by operational policy.[6] These three closely related elements of the overall context of policy-based lending at the country, Country Assistance Strategy (CAS), and policy levels can be understood as interacting (as shown in Figure 1) and should not be confused with conditionality, which is applied at the level of specific operations. The country's own development program, as reflected in a Poverty Reduction Strategy Paper (PRSP) or government strategy document sets out the country-level results and is the basis for the Bank's CAS. The CAS, in turn, defines a results framework for CAS outcomes to which the Bank's interventions contribute, and indicates a notional lending envelope and instrument mix, including development policy operations where appropriate.[7] Against this background, operational policy asks the Bank to take into account certain considerations before proceeding with the development policy operation.

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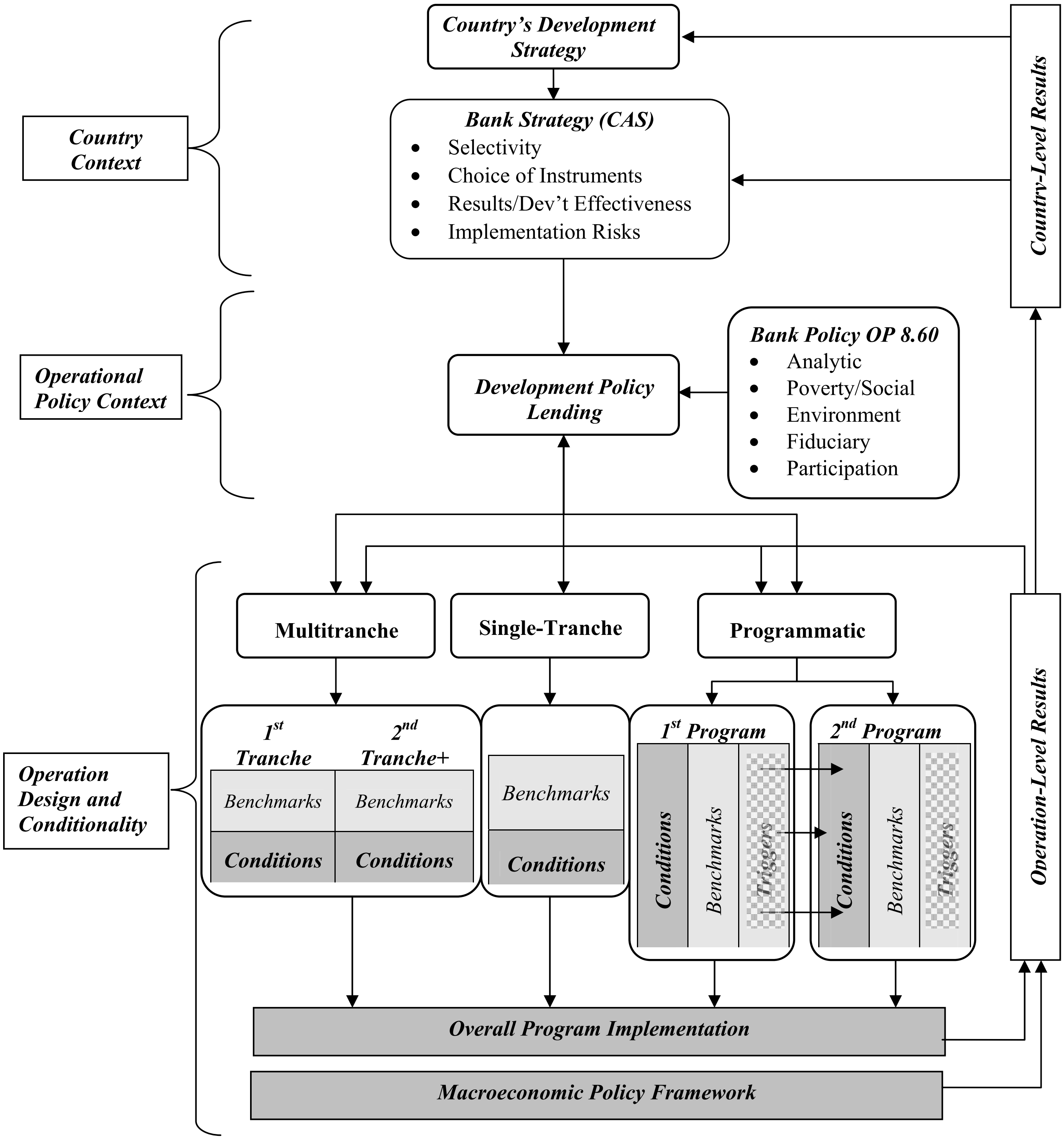
5 See IBRD and IDA Articles of Agreement, Articles I and III, respectively; and *World Bank Review of Conditionality: Legal Aspects of Conditionality in Policy Lending*, Legal Department, (SecM2005-0390/2), July 8, 2005 [Background Paper #2 of this volume]. The Bank's due diligence includes paying due regard to the prospect that the borrowing country will be in a position to meet its obligations under the loan.

6 OP 8.60, *Development Policy Lending*, paragraph 3.

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

Figure 1. Bank Approach to DPLs: Overview



7. ***Country's Development Strategy.*** The World Bank bases its support to a member country on the country's own vision for its development and strategy for achieving it. The Bank's approach reflects the conclusion of the literature on aid effectiveness, which shows that successful implementation of policies tends to be higher when the program is owned by the country, and that countries that have a medium- or long-term strategy tend to stay the course and be more consistent in policy implementation.[8] For IDA-eligible countries, this vision and strategy should be set out in a Poverty Reduction Strategy Paper.[9] While there is no such formalized approach for middle-income countries, the Bank can draw on the country's own vision expressed in the form of government declarations, budgets, development plans, or other strategy documents.

8. ***Country Assistance Strategy.*** The Bank develops its own business plan in a CAS that sets out the program of lending and nonlending support by which it proposes to support the country's vision and strategy.[10] The CAS reflects the Bank's strategy, and does not constitute an agreed plan of action with the country. In the CAS, the Bank exercises judgments about country selectivity in the allocation of Bank resources, and determines the appropriateness of providing development policy lending to a country. The Bank's decision to extend development policy lending is based on an assessment of the country's policy and institutional framework—including the country's economic situation, governance, environmental/natural resource management, and poverty and social aspects.[11] In the CAS, the Bank identifies the areas and aspects of the country's development strategy and policy program that it considers supporting and where it has a comparative advantage. Drawing on a consultative process, the CAS assesses the adequacy of analytic work on the country and indicates how gaps will be addressed. Lending support may include investment loans, guarantees, or development policy loans. Within a defined lending envelope, the Bank modulates its support according to country performance, which is gauged through a set of performance indicators.[12] In laying out the strategy, the Bank takes into account the strategies and engagements of other external development partners, including the Fund, other multilateral development institutions, and bilateral agencies. The CAS also establishes a clear results framework, including indicators to monitor progress in achieving the CAS outcomes supported by the Bank, building to the extent possible on the country's own system of monitoring and evaluation.

9. ***Bank Operational Policy Requirements.*** Development policy operations must be supportive of, and consistent with, the country's economic and sectoral policies and institutions.[13] When the Bank considers a development policy loan, OP 8.60 establishes a

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[8] *Review of World Bank Conditionality: The Theory and Practice of Conditionality: A Literature Review* (SecM2005-390/7) OPCS, July 12 2005 [Background Paper #5 of this volume].

[9] J. Klugman, ed., *A Source Book for Poverty Reduction Strategies*, World Bank, 2002.

[10] Bank Procedure (BP) 2.11, *Country Assistance Strategy*; and *Results Focus in Country Assistance Strategies: A Stocktaking of Results-Based CASs* (R2005-0042), February 24, 2005.

[11] OP 8.60, *Development Policy Lending*, August 2004, para 3.

[12] The CAS often uses specific triggers and performance indicators for different scenarios that modulate the Bank's assistance within a defined lending envelope and suggest a mix of lending instruments for a country. Triggers or performance indicators are expected to be linked to the changes in country performance that are most relevant to the achievement of the development objectives supported by the CAS.

[13] OP 8.60, paragraph 2.

number of requirements that must be complied with either before or during program implementation. These requirements form the basis for the Bank's decision to go forward with an operation:

- ***Analytic work.*** A development policy operation draws on relevant analytic work on the country undertaken by the Bank, the country, or other parties.
- ***Poverty and social impact.*** The Bank determines whether specific country policies supported by the operation are likely to have significant poverty and social consequences, especially on poor and vulnerable groups.[14]
- ***Environment, forests, and other natural resources.*** The Bank determines whether the specific policies supported by the operation are likely to cause significant effects on the country's environment, forests, and other natural resources.[15]
- ***Financial management systems.*** Drawing on relevant analysis of the country's public financial management, the Bank determines whether the operation should include measures to address identified fiduciary weaknesses.[16] When the Bank supports a program of a subnational entity, the due diligence is carried out at the subnational level as well.[17] The fiduciary assessment normally focuses on aspects such as the comprehensiveness and transparency of the budget, the systems that facilitate implementation and monitoring of the budget, fiscal transparency (reliable information on fiscal results and position), and the financial accountability for use of public resources.[18] When the available analysis identifies weaknesses in the borrower's central bank control environment or budget management system, or when an acceptable action plan to deal with identified fiduciary weaknesses

[14] For country policies with likely significant effects, the Bank summarizes in the Program Document relevant analytic knowledge of these effects and of the borrower's systems for reducing adverse effects and enhancing positive effects associated with the specific policies being supported. For additional guidance, Bank staff may refer to *Good Practice Note for Development Policy Lending: Poverty and Social Impact Analysis,* OPCS, October 2004*;* and *A User's Guide to Poverty and Social Impact Analysis*, Poverty Reduction Group and Social Development Department, World Bank, 2003.

[15] For country policies with likely significant effects, the Bank assesses in the Program Document the borrower's systems for reducing adverse effects and enhancing positive ones, drawing on relevant country-level or sector environmental analysis. For additional guidance, staff may refer to *Good Practice Notes for Development Policy Lending: Environmental and Natural Resource Aspects,* OPCS, October 2004.

[16] The Bank does not hold that there should be a minimum standard of public financial management that can be used as a precondition for development policy lending. Development policy operations could be provided in a country that has a weak public financial management environment but has committed itself to an adequate program of public financial management improvement and where there is reasonable evidence that improvements are occurring in a timely manner. Improved public financial management may be an outcome, rather than a precondition, of development policy lending.

[17] World Bank, *Good Practice Note on Subnational Development Policy Lending*, OPCS, June 2005.

[18] As in other cases, the country, third parties, or the Bank may carry out this analytic work. The Bank's principal analytic instruments are the Country Financial Accountability Assessment, Country Procurement Assessment Report, and the Public Expenditure Review. In addition to these, the Bank reviews the available published annual audit reports and financial statements of the government and other relevant reports that provide information on the country's public financial management system.

is not in place, the Bank will identify the additional steps needed to secure acceptable fiduciary arrangements for development policy lending.

- ***Consultations and participation.*** Because the Bank understands that the often complex policy and institutional programs associated with DPL can be adopted and implemented only when they have sufficient political support within the country, it advises the country to consult with, and engage the participation of, key stakeholders in the process of formulating the country's development strategies. For a development policy operation, the country draws on this process of strategy formulation to determine, in the context of its constitutional and legal framework, the form and extent of consultations and participation in preparing, implementing, and monitoring and evaluating the operation.

IV. CONDITIONALITY IN DEVELOPMENT POLICY OPERATIONS

10. Once a DPL is developed in the context of the country and Bank strategies and Bank operational policy, as summarized in Section II, the program is structured to allow the Bank to provide financing to the country in line with its due diligence. How the program will be structured depends on the choice among different modalities. Conditionality applies at the operational level when the Bank decides to disburse a development policy operation conditional on its judgment on the compliance with the critical program conditions, the adequacy of the macroeconomic policy framework, and the overall satisfactory implementation of the program.

A. Critical Program Conditions

11. Critical program conditions are the policy actions that are included in loan agreements as specific requirements for disbursing Bank resources. The Bank's approach to these conditions is defined in paragraph 13 of OP 8.60. Staff have also received further guidance in the form of good practice notes,[19] stocktaking exercises,[20] and recommendations issued by Bank Management.[21]

12. ***Characteristics of Program Conditions.*** As a general principle, the Bank's policy calls for including as program conditions only those actions of the country's program that are critical for the attainment of the expected results of the program. Identifying critical actions calls for a clear picture of the expected results and the corresponding causal chain that links the actions to those results. Beyond this general principle, the recommendations provided to Bank staff have stressed the importance of keeping the number of conditions low, especially in the case of the better performing

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19 OP/BP 8.60 is complemented by a series of good practice notes (available on the OPCS website) to provide additional guidance to staff, including on the design of development policy operations, poverty and social impact analysis, fiduciary arrangements, environmental aspects, budget support groups, subnational lending, and fragile states.

20 World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), April 29, 2005.

21 For example, "Disciplined Use of Conditionality in Lending Operations" (September 14, 2004), issued by the Vice President, OPCS.

countries.[22] The recommendations have also highlighted the need to focus on actions that are specific and monitorable, as well as clearly linked to the expected results.[23]

13. ***Tranching of Programs.*** Disbursements or tranches under DPLs may be structured in different forms, taking into consideration the borrowing country's policy environment, capacity, and policy record. In particular, tranching in DPLs may take the following forms:

- ***Single-tranche operations.*** In a single-tranche operation, the country fully meets the conditions for the loan or credit before the Bank presents the operation for Board approval; and when the program becomes effective, the Bank disburses all of the funds at once.[24] Even though there is no expectation of a subsequent operation to support the policy program, the Bank's policy requires these operations to be framed within a reasonably well-defined, medium-term policy program. The Bank generally uses self-standing single-tranche operations on an exceptional basis, mostly when countries are in crisis or have extraordinary financing needs.

- ***Multitranche operations.*** The Bank can provides development policy operations in two or more tranches, which it disburses as the borrower meets all the program conditions.[25] The critical conditions for each tranche are specified at the beginning of the operation, and are part of a well-defined medium-term policy program. Tranches may be *fixed*—that is, with their timing and sequence decided in advance—or they may be *floating*, conditioned on a particular policy action but with the country free to choose the timing. The multitranche approach is appropriate only when the details of key steps in a medium-term policy are already well understood. Traditionally, multitranche operations were the norm in Bank operations; now they are mostly used when the country needs to establish a track record of performance or in other specific circumstances, such as cases where it suits the country's authorities in a particular policy context.

- ***Programmatic operations.*** In a programmatic operation, a series of usually single-tranche operations is framed in a medium-term policy program, with a general expectation about the timing, policy steps, and financing amount to be involved in each operation of the series.[26] This approach captures the medium- to long-term nature of most significant policy efforts but allows the team flexibility to adjust to new information and changing circumstances during implementation, and to change the scope of the operation over time.[27] The link between the single-tranche programs of the programmatic series is formalized through a set of triggers, which are the expected prior actions for

[22] Management guidance to staff recommends, as a rule of thumb, the use of no more than 10 conditions per operation or tranche.
[23] World Bank, *Good Practice Note on Design of Development Policy Operations*, OPCS, October 2004.
[24] OP 8.60, paragraph 14.
[25] OP 8.60, paragraphs 14 and 18; and BP 8.60, paragraph 16.
[26] OP 8.60, paragraphs 14 and 18; and BP 8.60 paragraph 16.
[27] World Bank, *Programmatic Adjustment Lending Retrospective*, Report 26315, July 11, 2003.

the next operation in the series. The Bank bases its decision to proceed with the next operation on an overall assessment of progress against the triggers. The programmatic approach has now become the main modus operandi of development policy lending, as it embodies an approach to conditionality that is perceived as more flexible by the institution and that seems best suited to support countries with well-defined medium-term institutional policy programs.[28]

14. ***Types of Conditions.*** Within the above types of programs, conditions may take the following forms:

- ***Prior actions.*** Conditions are called prior actions when they represent policy actions that the country agrees to take *before* the Bank's Executive Board approves a loan. They are particularly appropriate when upfront implementation is deemed as critical for the success of the program. Single-tranche operations, whether self-standing or as part of a programmatic series, disburse on the basis of prior actions.

- ***Regular tranche conditions.*** These conditions of multitranche operations are policy actions whose timing can be foreseen in advance and are deemed critical for the attainment of program objectives.

- ***Floating tranche conditions.*** Within multitranche operations, floating tranche conditions may be appropriate when a particular policy action is critical for the attainment of the desired results but the timing of its implementation is uncertain and need not be tied to a specific date. Floating conditions provide the country with the needed flexibility to implement the policy action at a time the authorities consider appropriate in view of political economy or implementation considerations. They also allow flexibility in the pace of implementation, without specific actions holding up progress in the overall program.

- ***Effectiveness conditions.*** These conditions must be implemented between Board approval and before the loan becomes effective. They are rarely used and typically discouraged since they are often associated with implementation delays.[29]

15. ***Waivers and Multitranche Operations.*** When multitranche operations proceed in line with the original program, the Bank disburses to the country on the basis of a Tranche Release Document (TRD) that reports on progress under the program and that is sent to the Board for information.[30] When progress under the program is not as expected, the Bank has one of two options. It may delay disbursements until the country complies

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[28] World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), April 29, 2005.

[29] Effectiveness conditions are not contained in the loan agreement. See *Review of World Bank Conditionality: Legal Aspects of Conditionality in Policy Lending* (SecM2005-0390/2) Legal Department, June 29, 2005 [Background Paper #2 in this volume].

[30] OP 8.60, paragraph 31; and BP 8.60, paragraphs 19 to 21.

with the tranche conditions (informing the Board in a quarterly report); alternatively, the Bank may determine that there are valid reasons for the failure to fulfill the condition, and may request approval from the Board for waiving the condition on a non-objection basis. Several considerations may justify the request for granting a waiver. It may well be the case that the substance of the policy measure has been undertaken, but relatively minor noncompliance is mostly related to the very specific language used to define the condition. Alternatively, the initial tranche condition may have become irrelevant or exogenous shocks may have led to a change in the appropriate policy response. In still other cases, the issue may be one of outdated program design or an inappropriate assignment of criticality, with the policy program remaining on track in spite of the nonobservance of the tranche condition, or the country may have undertaken adequate compensatory policy actions.

16. ***Triggers and their Role.*** Within programmatic operations, triggers are the expected prior actions of the next operation in the programmatic series.[31] These expectations form the basis for the Bank's decision to proceed with the next operation. Nevertheless, they are not included in the loan agreements and are not conditions. In principle, triggers should be chosen because of their criticality to the achievement of the expected results of the overall program, which includes the sustainability of the program itself.[32] Triggers should be sufficiently well-specified and monitorable to avoid ambiguity and subjectivity.

17. ***Trigger Flexibility.*** The prior actions of the subsequent operation need not be identical to the triggers; triggers can be adapted to changing circumstances. Indeed, triggers entail considerable flexibility, because they are updated as actual prior actions and can be adapted to changing circumstances, or modified for better clarity, specificity, or measurability. This flexibility allows the Bank to take into account exogenous developments, the actual pace of implementation of the policy program, the lessons arising from implementation on the ground, and any possible improvements on the original policy program.[33] Nevertheless, teams are expected to provide a transparent description for the adaptations in the program documents of subsequent operations.[34]

18. ***Other Bank Options.*** Notwithstanding the flexibility of triggers, subsequent operations within a programmatic series need not take place as originally expected. In case of uneven country performance, the Bank has typically reacted by either delaying the next operation or reducing its amount.[35] The decision to proceed with the full amount can be made on the basis of an overall assessment of progress, for instance when faster-than-expected progress on one dimension of the program compensates for delays on other

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31 OP 8.60, paragraph 14, footnote 14; and BP 8.60, paragraph 16.

32 World Bank, *Good Practice Note for Designing Development Policy Operations*, OPCS, October 2004.

33 The higher degree of flexibility carries some risks, especially when triggers are defined vaguely. See Box 14 in *Poverty Reduction Support Credit: A Stocktaking* (IDA/SecM2005-0238), April 29, 2005.

34 This expectation is akin to the requirement to inform the Board on the fulfillment of tranche conditions or request its approval for waiving non-fulfilled condition.

35 *Programmatic Adjustment Lending Retrospective* (SecM/2003-333), July 11, 2003; and *Poverty Reduction Support Credit: A Stocktaking* (IDA/SecM2005-0238), April 29, 2005.

triggers. In other cases, a reduction of the amount of the operation may be seen as an appropriate response to incomplete achievement of triggers. In still other cases, unfulfilled triggers may be seen as a reason to delay the subsequent operation.

19. ***Scope for Outcome-Based Conditionality.*** The Bank's operational policy links the concept of conditions to policy actions. In practice, however, outcome-based conditions have been used pragmatically when appropriate.[36] Development policy operations typically provide indicators and targets related to policy actions, although in some cases indicators are given without targets, particularly where several policy actions are linked to a single target, or future performance is uncertain. As policy programs evolve over time, there is often a steady increase in the emphasis given to, and the quality of, outcome and impact indicators and targets in subsequent operations, particularly in the social sectors. Areas that are concerned with institutional changes (such as governance and public financial management), however, are less amenable to quantifiable outcome indicators. In some cases, particularly where results chains are clear and indicators are available, it might be possible to move to a greater reliance on outcome and impact indicators as conditions and triggers. The outcome-based approach provides the country with more leeway. Nevertheless, governments are wary of using outcome and impact targets as conditions of and triggers for credits when they are held accountable for outcomes outside their control.[37]

20. ***Variable Tranching.*** The European Commission and several bilateral donors have incorporated a "graduated approach" with a fixed and variable tranches.[38] Under this approach, the fixed tranche is designed to provide relatively predictable financing, or a "base flow" of budget support. It is broadly linked to indicators that are fundamental to program success and have a very high likelihood of being met, such as sound macroeconomic management (for which judgment is based on the IMF's assessment). The variable tranche is explicitly linked to performance. It may be linked mechanically to performance against specific indicators, whether formulated as specific measures, outputs, or in the case of the EC, on outcomes; and it may be disbursed partially. The Bank's Regional Strategy for Africa encourages experimentation with approaches such as variable tranching.[39]

21. ***Implications of Variable Tranching.*** Some caution is warranted in exploring the variable approach in the World Bank context. Variable tranching based on policy actions or inputs would reintroduce the traditional ex ante conditionality of multiple tranching that must be specified and met without flexibility. Moreover, under the Bank's operational policy, even a fixed tranche would still be conditional on an adequate macroeconomic policy framework and overall satisfactory implementation. While the

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36 OP 8.60, paragraph 13. For implementation of the OP, see *Review of World Bank* C*onditionality: Review: Recent Trends and Practice* (SecM2005-390/4), June 30, 2005 (paragraphs 33 to 35) [Background paper #3 in this volume].

37 Box 9, *Poverty Reduction Support Credit: A Stocktaking* (IDA/SecM2005-0238), April 29, 2005.

38 S. Koeberle and Z. Stavreski, *Budget Support: Concept and Issues*, Practitioners Forum on Budget Support, World Bank, May 2005.

39 World Bank Africa Region, *Strategic Framework for IDA's Assistance to Africa: The Emerging Partnership Model*, June 25, 2003

use of outcome indicators should be encouraged, their use as conditions of disbursement is only advisable to the extent that these outcomes can be largely under the control of the authorities and can be measured on a timely basis.[40]

22. ***Conditionality at the Country Program Level.*** During the Bank's consultations on conditionality, some participants suggested more drastic changes in the modality of conditionality by moving conditionality from the level of individual operations to the level of the country's program. In particular, proponents consider that such change would enhance ownership and medium-term predictability of aid by conditioning levels of policy-based lending on the overall performance (including fiduciary management) of a country in implementing its program, rather than tying conditions to specific policy actions.[41] To understand some of the impact of such a move on aid efficiency, this review has stimulated some analytic background work on this subject that has informed the consultations.[42] The analytic work shows that simply tying aid to the Country Performance Institutional Assessment for an IDA replenishment period would potentially result in fairly modest aid allocation "errors." However, such an approach would imply a radical change to the Bank's current governance architecture as it could require that (a) the CAS be negotiated and agreed with the country; (b) the CAS become a Board-approved document allocating resources over a three to four year period based on CPIA scores or creditworthiness criteria; (c) all or a large part of financing be delivered as fast-disbursing operations; (d) the Board drop its prerogative to review individual lending operations during the CAS period; and (e) annual disbursements be automatic absent major changes in policy implementation. This review has therefore not pursued such a proposal.

B. Adequate Macroeconomic Policy Framework

23. Operational policy[43] requires an adequate macroeconomic policy framework whenever a development policy operation is disbursed.[44] The determination of the adequacy of the macroeconomic policy framework is a responsibility of the Bank, within its own accountability framework. The existence of an IMF program is usually an important input in this determination.[45] If there is no IMF arrangement, Bank staff

40 For a full discussion of the scope of using outcome-based conditionality by the Bank, see Box 9 in *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), May 12, 2005.

41 *Partnerships for Poverty Reduction: Rethinking Conditionality,* Department for International Development, Foreign and Commonwealth Office, and HM Treasury, London, March 2005.

42 B. Eifert and A. Gelb, *Improving the Dynamics of Aid: Towards More Predictable Budget Support,* World Bank, 2005.

43 OP 8.60, especially paragraphs 5 and 13.

44 In the case of countries using IBRD resources or IDA credits, the Bank also looks at the macroeconomic policy framework from the perspective of the country's ability to repay. From this perspective, the following considerations are pertinent: (a) does the country have sustainable debt dynamics in terms of a likely achievement of external and fiscal balances over the medium term; (b) does the development policy operation support rather than undermine policies in support of sustainable debt dynamics; and (c) can the Bank accept the credit risk associated with the operation, taking into consideration the country's updated macroeconomic outlook and the risks arising from potential external and internal shocks.

45 The Bank's operational policy only requires the presence of a disbursing IMF program in the case of special development policy lending. See OP 8.60, paragraph 25.

ascertain, before making their own assessment, whether the Fund has any major outstanding concerns about the adequacy of the country's macroeconomic policies. Any outstanding issues relevant to the adequacy of the macroeconomic policy framework raised by the IMF are communicated to Executive Directors.

24. ***Bank-Fund Framework.*** The existing framework for Bank-Fund collaboration addresses the Board's concerns of being fully informed on the most recent understanding of the IMF on the macroeconomic policies of the borrowing country. The IMF views are communicated to the Bank Board in an annex—the Fund Relations Note—attached to the program document. The Fund Relations Note is typically the Public Information Notice (PIN) following an Article IV consultation or Chairman's Statement following an IMF Board discussion of a program. When these documents are more than six months old or when there have been significant developments, the IMF provides an assessment letter as the Fund Relations Note. The existing framework also foresees an upstream engagement of the issues between the staffs, as well as the presence of Fund staff in Board discussions to respond to Executive Directors' concerns.

25. ***Bank Assessment of Macroeconomic Policy Framework.*** The Bank has approved a DPL in the absence of an IMF program on a number of occasions.[46] In all cases, the Bank's Board was fully informed of any concerns the IMF's may have had. In several country cases where the Bank was particularly concerned about the macroeconomic policy framework, either because of actual or potential risks, teams included particular aspects of macroeconomic policy framework as part of the critical conditionality of the operation. When the general policy framework is included there, it serves as a signal to the country about the Bank's concern and the special attention with which macroeconomic policy developments will be followed. The inclusion of particular macroeconomic policies or indicators within the critical conditions tends to be more complex, in light of the IMF's role as lead agency in this area, as defined in the existing framework for Bank-Fund collaboration. Close coordination with the IMF is central in these cases, to avoid cross-conditionality or inconsistent conditions.

C. Satisfactory Overall Program Implementation

26. Operational policy[47] also conditions development policy lending on the country implementing the overall program in a matter satisfactory to the Bank. Policy matrices are an input to this evaluation. Aside from the critical conditions of the program and the triggers, policy matrices include a significant number of benchmarks and some outcome indicators.[48] These benchmarks are the noncritical actions planned for the second or later year of a program, which are complementary to the conditions and triggers and which give a sense of the general direction of the program. Within the overall assessment of progress in implementing the program the Bank also reviews how the actions and outcomes in the policy matrix are being implemented. While conditions and triggers carry a heavier weight on what happens to the flow of resources to the country under the

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[46] Recent examples include *Ukraine Second Programmatic Adjustment Loan* and *Vietnam Third Poverty Reduction and Support Credit*, both approved in FY04.

[47] See OP 8.60, especially paragraph 13.

[48] See OP.8.60, paragraph 14, footnote 14.

program, the assessment of progress under benchmarks is looked at nonetheless.[49] Progress with benchmarks therefore helps shape the Bank's perception of the country's track record.

27. ***Benchmarks.*** In contrast to conditions or triggers, progress benchmarks in program matrices serve as a management tool to describe the contents and results of the government's program in areas monitored by the Bank.[50] Benchmarks therefore do not need to meet the criticality test applied to conditions and triggers. Instead, they have frequently been used to describe small steps in a reform process (such as the preparation of studies and action plans) that represent significant, though not necessarily critical, progress markers for the implementation of the program. They are not legal conditions for disbursements of Bank loans or grants and are not intended to become prior actions for future support. However, they are sometimes perceived as closely related to Bank conditions, as they define an area of the Bank's policy involvement and help to gauge overall program implementation.[51]

D. Conditionality and Coordination with Development Partners

28. Operational policy also requires the Bank to coordinate with the IMF and other international financing institutions and agencies, as appropriate, while retaining responsibility for its financing decisions.[52]

29. ***Bank-Fund Collaboration.*** The Bretton Woods institutions established a framework to enhance effective Bank-Fund collaboration, and they regularly carry out reviews of how the framework is operating.[53] Within this framework, the guidelines call for avoiding duplication or overlap of conditionality to the extent possible.[54] They also ask teams to coordinate all aspects of lending operations, with a view to improving the quality of policy advice, reducing coordination costs to member countries, and avoiding conditions that undermine or are inconsistent with each other's programs. A key element of the framework is that each institution is accountable for its own lending decisions, including the choice of conditions and the verification of compliance. Accordingly, the guidelines rule out cross-conditionality, understood as one institution basing its lending decisions on a decision by the other one.

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[49] See OP 8.60, paragraph 1.

[50] See OP.8.60, paragraph 14, footnote 14.

[51] See OP 8.60, especially paragraph 13.

[52] See OP 8.60, paragraph 7.

[53] *The IMF and the World Bank Group: An Enhanced Partnership for Sustainable Growth and Poverty Reduction, Joint Statement by Horst Köhler, Managing Director, and James Wolfensohn, President* (SecM2000-536), September 5, 2000. See also *Report of the Managing Director and the President on Bank-Fund Collaboration* (SecM98-733 and SM/98/226), September 4, 1998. On earlier efforts at improving collaboration, see the annex titled "History on Bank-Fund Cooperation on Conditionality" in *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality* (SecM2001-0461/1, August 24, 2001; and SM/01/219, Supplement 1, Revision 1, August 23, 2001). The most recent review of collaboration is contained in *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality—Progress Report* (SecM2004-0070/1, and SM/04/57), February 24, 2004. The next review of collaboration is scheduled for 2007.

[54] *Operationalizing Bank-Fund Collaboration in Country Programs and Conditionality—Staff Guidance Note,* April 24, 2002.

30. ***Harmonization.*** Following the Rome High-Level Forum of February 2003, bilateral agencies have joined forces with the IMF, other multilateral development banks, and the Bank to try to harmonize their policies, procedures, and processes in the interest of enhancing aid effectiveness and reducing the transactional burdens on partner countries. The Rome Declaration stated that the High-Level Forum had agreed on an "important international effort to harmonize the operational policies, procedures, and practices of our institutions with those of partner country systems to improve the effectiveness of development assistance, and thereby contribute to meeting the Millennium Development Goals."[55] These commitments were reaffirmed and enhanced in the Paris High-Level Forum of March 2005. While the term "harmonization" is associated mostly with aid to low-income countries, the principles, objectives, and concerns are equally valid for middle-income countries.

31. ***Coordinating Conditionality among External Development Partners.*** The World Bank and multilateral and bilateral external development partners have explored various avenues to advance harmonization in low-income countries. In some countries, they have coordinated conditionality and supervision. In others, some agencies are cofinancing poverty reduction support credits or other development policy lending. In several well-performing low-income countries, a higher degree of harmonization has emerged, with multiple agencies relying on a common policy matrix agreed with the partner country; in some cases coordinating their work through budget support groups with their rules of engagement outlined in memoranda of understanding.[56] In all these cases, the Bank has adhered to the same principles of avoiding cross-conditionality and ensuring that conditions from different agencies do not contradict each other.[57]

V. CONCLUSIONS

32. Conditionality in the World Bank context is defined as the set of conditions that, in line with the Bank's operational policy, can affect the flow of resources to a country. These conditions include the critical program conditions, an acceptable macroeconomic policy framework, and satisfactory overall program implementation. The rationale for conditionality is the Bank's due diligence obligation to ensure that its resources are used effectively and responsibly by the borrowing country. This obligation will remain with the institution. Conditionality understood in this way is here to stay—but it can be exercised in different forms.

33. ***Bank Approach.*** The Bank's approach to conditionality in policy-based lending has changed over time. It allows the institution to carry out its due diligence, while at the same time helping borrowing countries improve their growth prospects and reduce poverty. As applied today, the approach is consistent with a view that conditionality is

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[55] Rome Declaration on Harmonization, February 25, 2003, at www.aidharmonization.org.

[56] World Bank, *Good Practice Note on Development Policy Lending: Budget Support Groups and Joint Financing Arrangements*, OPCS, June 2005.

[57] As discussed in *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), April 29, 2005, there are several potential challenges in the harmonization agenda, including volatility, the size of the performance assessment framework, the weight of donor influence, and the risk of donor collusion.

neither coercion nor inducement—the Bank now strives to define its assistance strategy in alignment with the country's own development strategy, and to design its programs in support of a country's efforts to implement its own development strategies and achieve its development objectives.

34. ***Adapting to Country Institutional Capacity.*** The Bank's approach is especially suited to taking into account the particular characteristics and circumstances of borrowing countries, allowing the Bank to calibrate the recourse to critical conditions and benchmarks in line with the country's own institutional capacity. Within the CAS, the Bank reflects the country's own development strategy and aligns its program with the country's own development objectives. It also exercises its selectivity at that stage, by defining the lending envelope and instrument mix. The operational policy requirements serve to strengthen the country's institutional capacity, while at the same time determining the framework for the Bank's exercise of due diligence. If the Bank deems that the likelihood of sustainability is sufficiently great, as indicated by a strong track record, the need to apply critical program conditions and benchmarks diminishes considerably. In some cases, the best performing borrowing countries that also have strong institutional capacity have been supported with programs that were designed with very few critical conditions and with streamlined program matrices.

35. ***Challenges: Flexibility and Discretion.*** The Bank's approach, however, does create a few challenges. The first one comes from the flexibility inherent in the judgments made by the Bank, such as in moving from one programmatic operation to another or in the assessment of the macroeconomic policy framework or the overall progress of the program. Flexibility entails a high degree of discretion to be exercised by Bank teams, reducing the degree of certainty for the borrowing country. The challenge for the Bank is to exercise this discretion judiciously, consistently, and transparently.

36. ***Challenges: Policy Matrices.*** A second challenge stems from the way in which policy matrices are prepared and used. While advice to Bank teams has emphasized the need to focus on a few critical conditions and triggers that are truly essential for the achievement of the program results, teams have had considerably more latitude regarding benchmarks and outcome indicators. Some stakeholders have pointed at the length of the resulting matrices. The challenge for the Bank is to avoid overloading the matrices, while focusing on steps that are critical for the results of the program.

37. ***Challenges: Aligning CAS and DPL Results.*** A third challenge arises from the link between the CAS results framework and individual DPL operations. If the results focus of the operations is not adequately linked to the CAS outcomes, the Bank's approach to conditionality loses effectiveness and its results orientation. The challenge for the Bank is to keep the results focus of the programs aligned with the expected CAS outcomes.

38. ***Challenges: Coordination among External Development Partners.*** Yet a fourth challenge arises from the complexities brought about by harmonization and coordination with a large number of development partners. In this context, it is important to minimize the risk that the conditions used by development partners and the Bank contradict or

impair each other. To the extent that there is a clear division of labor among the partners and their conditionality, each partner's approach to conditionality can be effective and can reduce transaction costs. However, where partners and the Bank strive to bring all of their conditionality into a single unified matrix, it is easier to lose focus on both the criticality of some conditions and the sense of direction of anticipated results. The challenge for the Bank is to conduct its due diligence and coordinate its conditionality with other development partners, while keeping the CAS results in mind and retaining the Bank's own distinct accountability.

REVIEW OF WORLD BANK CONDITIONALITY
BACKGROUND PAPER 2

LEGAL ASPECTS OF CONDITIONALITY IN POLICY-BASED LENDING

LEGAL VICE PRESIDENCY
WORLD BANK

ABBREVIATIONS AND ACRONYMS

BP	Bank Procedure
CAS	Country Assistance Strategy
DPL	Development Policy Lending
ESW	Economic and sector work
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
OD	Operational Directive
OP	Operational Policy
OPCS	Operational Policy and Country Services

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Review of World Bank Conditionality: Legal Aspects of Conditionality in Policy-Based Lending

Contents

REVIEW OF WORLD BANK CONDITIONALITY:

LEGAL ASPECTS OF CONDITIONALITY IN POLICY-BASED LENDING

EXECUTIVE SUMMARY

1. This paper discusses the legal aspects of conditionality in World Bank policy-based lending operations. These operations are authorized under the "special circumstances" provisions in IBRD and IDA's Articles of Agreement. They are processed under Operational Policy (OP) 8.60 and Bank Procedure (BP) 8.60. Unlike investment loans made for specific projects, policy-based operations provide rapidly disbursing policy-based financing for a borrower's actual or anticipated development financing requirements. These loans were initially introduced in the Bank's lending menu in 1980 in the form of structural adjustment lending. The concept of "conditionality" evolved from the borrower's program of reforms and actions that formed the principal basis for the Bank's support.

2. ***What is Conditionality?*** There is no formal definition of "conditionality" in the Bank's legal framework or operational policies. Paragraph 13 of OP 8.60 identifies three essential requirements for the Bank to make disbursements in a policy-based loan. They are: (a) maintenance of an adequate macroeconomic policy framework; (b) implementation of an overall program in a manner satisfactory to the Bank; and (c) compliance with critical policy and institutional actions.

3. These requirements are the Bank's "conditions" for its policy-based operations. They are reflected in the applicable legal agreements. Besides these conditions, an operation's program matrix includes various other elements, such as triggers, outcomes, and benchmarks. These elements are not reflected in a program's legal agreements as "conditions," and they are not determinative of disbursements.

4. ***Articles and Conditionality.*** The Bank's Articles of Agreement do not specifically prescribe or regulate conditionality in policy-based lending. However, the use of conditionality in these operations can be regarded as consistent with certain key Articles provisions:

- The "special circumstances" provision is the statutory basis for policy-based lending. The Bank enjoys wide discretion in fashioning its response to special circumstances. Through the Bank's practice, conditionality in the form of a borrower's program of specific policy and institutional actions has become an essential aspect of policy-based lending under "special circumstances." (IBRD Articles, Article III, Section (4) (vii) and IDA Articles, Article V, Section (1) (b).)

- All Bank activities must conform to the developmental "purposes" including the concept of productive purposes enshrined in the Articles. Even when responding to "special circumstances," the Bank's policy-based loans must be in accordance with the "purposes" identified in the Articles. Thus, where certain policy and institutional actions and measures are considered necessary for an operation to achieve the Bank's development purposes, these "conditions" may be validly justified under the Articles. (IBRD and IDA Articles, Article I.)

- The IBRD Articles recognize that the institution may provide financing for productive purposes on “suitable conditions,” while under its Articles, IDA may provide financing on “appropriate” terms. (IBRD Articles, Article I (ii) and IDA Articles, Article V, Section 2 (b).)

5. ***Conditionality in Bank Legal Agreements.*** A borrower’s “program” of actions, objectives, and policies constitutes the basis for Bank support through a policy-based loan. Legal agreements for policy-based operations require the borrower to “exchange views” with the Bank on any actions that could materially reverse a program's objectives or any specific actions listed in the legal agreements. The borrower’s commitment to execute its program has been generally regarded as not contractually enforceable. But the Bank has certain disbursement options if a borrower fails to undertake program conditions. These options can be exercised in three situations.

- ***Failure to consult the Bank on program changes after disbursement.*** The Bank may provide notice, and could after 60 days, accelerate the loan (although it has never exercised this option).

- ***Failure to comply with tranche-release conditions.*** The Bank has four options:

  (a) refuse to make the tranche release;

  (b) suspend future disbursements if the failure is due to a situation that shall make it improbable that the program will be carried out;

  (c) cancel the loan if the borrower’s right to withdraw loan proceeds remains suspended for 30 days; and

  (d) review the situation and provide notice to the borrower on actions to be carried out within 90 days, and cancel the loan if the borrower fails to take these actions within the 90-day period.

- ***Inconsistent actions after tranche-release conditions are satisfied.*** The Bank may refuse to make the tranche release or suspend the right to future disbursements under the loan.

REVIEW OF WORLD BANK CONDITIONALITY:
LEGAL ASPECTS OF CONDITIONALITY IN POLICY-BASED LENDING

I. INTRODUCTION

1. This background paper discusses the legal aspects of conditionality in World Bank policy-based lending operations.[1] It provides an overview of the principal legal considerations based on the history, evolution, and general practice of using conditionality in policy-based lending, and it does not purport to offer new legal pronouncements on this matter.

2. ***Policy-Based Operations.*** Policy-based operations are authorized under the "special circumstances" provisions in IBRD and IDA Articles of Agreement.[2] They are processed under Operational Policy ("OP") 8.60 and Bank Procedure ("BP") 8.60 and financed through IBRD loans, IDA credits, or IDA grants. Consistent with the review exercise this paper focuses only on conditionality in policy-based lending.[3]

3. ***Structure of the Paper.*** This paper is organized as follows. Section II traces the evolution of the term "conditionality" and explores its meaning in the Bank's policy-based operations. Section III examines the legal basis for conditionality under IDA and IBRD's Articles of Agreement. Section IV discusses the manner in which conditionality is incorporated in the Bank's legal agreements with borrowers. Finally, Section V identifies certain legal and policy issues that have arisen through the use of conditionality in the Bank's policy-based operations. To effectively handle these issues, that section highlights certain legal and operational considerations that should guide the formulation of conditionality in future operations.

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[1] In this paper, unless expressly indicated to the contrary or the context requires otherwise, references to "the Bank" or the "World Bank" include both the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA); the "Board" denotes the Boards of Executive Directors of IDA and IBRD; "borrower" includes a borrower under an IBRD loan and a recipient of an IDA credit or grant; "IMF" or "Fund" refers to the International Monetary Fund; "Articles" means both IDA and IBRD's Articles of Agreement; "lending" includes making an IBRD loan, an IDA credit, or an IDA grant; "loans" include IBRD loans and IDA credits and grants; "loan agreement" includes an agreement between the Bank and the borrower providing for an IBRD loan as well as an agreement for IDA financing (through a credit or grant). For subnational policy-based operations, certain references in this paper to the "borrower" also include the relevant subnational units (such as states or provinces) that are supported by these operations.

[2] See IBRD Articles, Article III, Section (4) (vii) ("loans made or guaranteed by the Bank shall, except in special circumstances, be for the purpose of specific projects of reconstruction or development"). There is a similar provision in Article V, Section (1) (b) of IDA's Articles.

[3] The Bank has two principal lending instruments: investment loans and policy-based loans. Investment loans provide financing for a wide range of activities that create physical and social infrastructure necessary for poverty alleviation and sustainable development. See Operational Policy and Country Services (OPCS), *World Bank Lending Instruments: Resources for Development Impact* 5 (2001). Policy-based loans provide rapidly disbursing policy-based financing, which the Bank provides in the form of loans or grants to help a borrower address actual or anticipated development financing requirements that have domestic or external origins. See OP 8.60 ¶ 1.

II. PRELIMINARY CONSIDERATIONS

4. Conditionality was a relatively unused term in Bank operations until the introduction of structural adjustment loans in 1980.[4] Until that time, Bank operations generally involved lending for "projects," although the Bank also made certain loans that were not for specific projects.[5] Project lending did not generally include any macroeconomic or policy-based conditions. These policy reforms and actions were, however, a common feature in the IMF's balance-of-payments support operations.[6]

5. Structural adjustment loans formally introduced the concept of "conditionality" in Bank operations. These loans were initially designed to help countries with severe balance-of-payments problems undertake economic policy reforms. To obtain an adjustment loan, a borrower would propose a reform "program" to correct imbalances in its economy.[7] This program would comprise a series of policy changes and institutional reforms to achieve efficient use of resources.[8] The Bank's financing supported this program.

6. The Bank's policy guidance on adjustment lending was codified in December 1992 through the adoption of Operational Directive (OD) 8.60. This directive identified certain pre-

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4 See Jacques Polak, "The World Bank and the IMF : A Changing Relationship," in *The World Bank: Its First Half Century,* vol. 2, 473-523, 486 (Devesh Kapur, John P. Lewis, and Richard Webb, eds., Brookings Institution Press 1997), which notes that a prominent historical treatise on the Bank written in the 1970s used the term "conditionality" to describe conditions imposed by the Fund.

5 The Bank's Articles require that loans and guarantees be made for "specific projects" except in "special circumstances (IBRD and IDA Articles, *supra* n. 2). In 1946, the Bank's Executive Directors interpreted the Articles to recognize that, in special circumstances, the Bank could make economic reconstruction loans, including long-term stabilization loans. IBRD Board Committee on Interpretation, *Authority of the Bank to Make or Guarantee Loans for Programs of Economic Reconstruction* (September 20, 1946) ("*Authority to Make Loans for Programs*"). In fact, the first four loans made by the Bank were not for specific projects, but rather for the reconstruction and economic recovery of France, the Netherlands, Luxembourg, and Denmark. Before the introduction of structural adjustment loans, non-project lending under "special circumstances" mostly comprised "general-import loans" that financed agreed lists of imports. See generally, Memorandum from the Vice President and General Counsel, *Authorized Purposes of Loans Made or Guaranteed by the Bank*, SecM-88-517, ¶ 13 (May 10, 1988) ("*Authorized Purposes Opinion"*) reprinted in Ibrahim F. I. Shihata, *The World Bank Legal Papers* 157 (Martinus Nijhoff Publishers 2000) (*"Legal Papers*"), which discusses the history of Bank operations under the "special circumstances" provision. For a discussion of the evolution of investment loans, see Operations Policy and Strategy, *Programmatic and Emergency Adjustment Lending: World Bank Guidelines* 2 (September 29, 1998) ("*Programmatic Guidelines*").

6 The origin of the term "conditionality" at the Fund can be traced to the Article V (3) (a) of its Articles of Agreement. See generally Joseph Gold, *Use of the International Monetary Fund's Resources: "Conditionality" and "Unconditionality" as Legal Categories*, 6 Journal of International Law and Economics 1-26 (1970). This provision, which is captioned "conditions governing use of the Fund's general resources," reads:

> The Fund shall adopt policies on the use of its general resources, including policies on a stand-by or similar arrangements, and may adopt special policies for special balance-of-payment problems that will assist members to solve their balance-of-payments problems in a manner consistent with the provisions of this Agreement and that will establish adequate safeguards for the temporary use of the general resources of the Fund.

IMF Articles of Agreement, Article V (3) (a). Note, however, that although the Bank and the Fund's Articles overlap in some respects, the responsibilities of each institution differ in some vital aspects as do the obligations of their respective members states. See Shihata, *Legal Papers*, supra n. 5 at 773-797.

7 See Memorandum from the President, *Structural Adjustment Lending*, R80-122, IDA R80-83, ¶ 13 (May 9, 1980) ("*Structural Adjustment Lending Memorandum*") cited in Shihata*, Legal Papers, supra* n. 5 at 164.

8 See *Authorized Purposes Opinion, supra* n. 5 at ¶ 17.

conditions for adjustment lending and contained various prescriptions regarding conditionality.[9] Over time, responding to changing borrower requirements, the Bank gradually developed a diverse menu of adjustment lending options. Traditional structural adjustment loans were supplemented by sector adjustment loans and credits, subnational adjustment loans and credits, programmatic adjustment operations, and poverty reduction strategy credits to handle varying borrower requirements.[10] These changes were reflected through successive operational memoranda to update the provisions of OD 8.60.[11]

7. In August 2004, a new framework for policy-based lending was introduced through OP 8.60. Among other things, the new policy replaced the existing types of adjustment loans with a single instrument called a development policy loan.[12] According to OP 8.60, development policy lending aims to help countries achieve sustainable reductions in poverty through a program of policy and institutional actions that promote growth, enhance the well-being and increase the incomes of poor people.[13] As this paper explains below, compliance with *critical* program measures and actions, maintenance of an adequate macroeconomic policy framework, and satisfactory program implementation constitute "conditions" for the Bank to release loan proceeds.

8. ***What is Conditionality*?** There is no formal definition of "conditionality" in OP 8.60 or in any other Bank policy or procedure. Paragraph 13 of OP 8.60, however, refers to the term "conditions" in the following manner:

> The Bank determines which of the agreed policy and institutional actions by the country are critical for the implementation and expected results of the program supported by the development policy loan. The Bank makes the loan funds available to the borrower upon maintenance of an adequate macroeconomic policy framework, implementation of the overall program in a manner satisfactory to the Bank, and compliance with these critical program conditions.

9. The policy states that three essential conditions or requirements must be satisfied for the Bank to make disbursements in a policy-based loan. These conditions are: (a) maintenance of an adequate macroeconomic policy framework; (b) implementation of an overall program in a manner satisfactory to the Bank; and (c) compliance with critical policy and institutional actions that are critical for the implementation and expected results of the program. Thus, from a policy

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9 See O.D. 8.60 ¶ 47. This directive replaced an earlier operational circular. See Operational Manual Circular 87/06, *Guidelines for Preparing and Processing Adjustment Loans and Credits* (November 23, 1987).

10 The Bank also made special structural adjustment loans to countries affected by the East Asia crisis in the late nineteen nineties. See OPCS, *Adjustment Lending Retrospective: Final Report* ¶ 2 (June 15, 2001) ("*Adjustment Lending Retrospective*").

11 See, e.g., OPCS, *Adjustment Operations – Documentation of Policy Performance in Initiating Memoranda* (March 31, 1988); *Tranche Release for Adjustment Operations*, (January 21, 1992); *Simplifying Disbursement under Structural and Sectoral Adjustment Loans*, (February 8, 1996); *Guidelines for Special Structural Adjustment Loans*, (April 19, 1999); *Guidelines for Programmatic Adjustment Loans/Credits*, (February 11, 2000); and *Interim Guidelines for Poverty Reduction Support Credits (PRSCs)* (May 31, 2001).

12 See OPCS, *From Adjustment Lending to Development Policy Lending: Update of World Bank Policy* ¶ 20 (August 2004) ("*Development Policy Lending Update*").

13 OP 8.60 ¶ 2.

perspective, these conditions are what the Bank considers to be "conditions" in its policy-based operations, and are appropriately reflected in the legal agreement for these operations.[14]

10. Policy and institutional conditions in a program vary in number, scope, and content depending on the operation.[15] They may include institutional actions, modifications in policies, sustained implementation of policies, maintenance of a satisfactory macroeconomic framework, and even analytic work.[16] But, as a general rule, only those actions and measures deemed *critical* for achieving the outcome of a program constitute conditions for the Bank to disburse funds together with the other requirements of a satisfactory macroeconomic policy framework and satisfactory program implementation.[17]

11. ***Single-Tranche versus Multitranche Loans.*** Policy-based loans can be structured with either a single or multiple tranches. In a single-tranche operation, the entire loan amount is made available for withdrawal when the legal agreements are declared effective. This usually takes place after the borrower complies with all the conditions for the Bank to make disbursements under the loan. In a multitranche operation the loan is disbursed in several stages or tranches as successive program conditions are met.[18]

12. ***Programmatic Approach.*** The Bank's policy lending to a borrower may follow a programmatic approach that includes a series of single-tranche operations within a medium-term framework. Where such an approach is used, the borrower's compliance with all conditions necessary for disbursement under one single-tranche loan should be distinguished from actions necessary to satisfy triggers or benchmarks (discussed below) for future Bank loans under the medium-term program.[19]

13. ***Prior Actions.*** Critical conditions (policy and institutional actions) in a single-tranche operation are usually met before the operation is presented to the Board for approval. These conditions are referred to as *prior actions* and are listed in a schedule to the legal agreement between the Bank and the borrower for the operation. It is possible that in some single-tranche operations certain conditions can only be met after Board approval. In such cases, the conditions must be satisfied before the loan is declared effective, and they are formulated as special conditions of effectiveness, which are indicated in the legal agreement.[20]

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14 In some subnational policy-based operations, these conditions may also be reflected in a project agreement with the subnational unit.

15 See OPCS, *Review of World Bank Conditionality: Issues Note* 4 ¶ 9 (January 24, 2005) ("*Issues Note*").

16 See OPCS, *Designing Development Policy Operations*, in *Good Practice Notes for Development Policy Lending* Section V, 12-20 (October 2004) ("*Design Good Practice Note*"). A companion paper to this legal paper explains the different categories of conditions used in policy-based operations. OPCS, *Review of Conditionality: Recent Trends and Practices* (2005).

17 In subnational policy-based operations, these critical actions and measures may be the responsibility of subnational units, such as states and provinces, which are supported by these operations.

18 See OP 8.60 ¶ 14.

19 While complying with prior actions for an operation before board presentation, a borrower may elect under the "deferred drawdown option" to defer a single-tranche loan's disbursement for up to three years. Disbursements under this option are contingent on satisfactory program implementation and a macroeconomic policy framework. See OP 8.60 ¶¶ 21-22.

20 Note that a distinction should be made between "standard" and "special" conditions of effectiveness. Standard conditions of effectiveness apply to all Bank loans. They require the borrower to show that the execution and

14. ***Tranche-Release Conditions.*** In these operations, the borrower may comply with certain conditions after Board approval and effectiveness. These conditions are included as tranche-release conditions. They must be satisfied for subsequent tranches, after the first one, to be released. Tranche-release conditions are also reflected in the legal agreement.

15. ***Triggers, Outcomes, and Benchmarks.*** Aside from the critical policy and institutional actions, which constitute a program's "conditions" together with a satisfactory macroeconomic policy framework and program implementation, a policy-based operation usually includes other substantive elements. These elements include triggers (used in programmatic operations to assess achievement of outcomes, they are expected prior actions for future loans); outcomes (desired changes that result from the actions); and benchmarks (standards against which performance or achievements are assessed).[21] These elements are usually reflected together with the critical conditions in an operation's program matrix.[22] But triggers, outcomes, and benchmarks are not reflected in a program's legal agreements as "conditions," and they are not determinative of disbursements.

16. Triggers are especially significant to programmatic policy-based lending, which usually consists of a series of single-tranche loans in support of a government's medium-term program. Triggers represent a notional set of expected prior actions for future operations that are essential to the medium-term program's sustainability. Compliance with triggers indicates sufficient progress to move from one loan to the next if other general requirements, such as satisfactory macroeconomic framework and program implementation, are met. Triggers for the first operation are expected to become prior actions for the subsequent one. Using triggers in programmatic lending as indicative measures of progress provides greater operational flexibility than multitranche operations, since tranche-release conditions must be waived if they are not complied with. They are not reflected in the legal agreement for an operation, although they may become prior actions for subsequent operations.[23]

17. ***Standard Contractual and Fiduciary Requirements for an Operation.*** It is also important to distinguish "conditionality" from standard contractual and fiduciary requirements in Bank legal agreements regarding the use of loan proceeds. All legal agreements for policy-based operations generally include a negative list of excluded expenditures for which the borrower may not use the loan proceeds.[24] But this limitation—as well as the financial management, audit, and loan repayment provisions—is not considered part of a policy-based operation's conditionality.

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delivery of legal agreements between the Bank and the borrower have been duly authorized or ratified by all necessary governmental or corporate actions. Special conditions of effectiveness consist of specific actions or measures that may vary depending on the nature of the operation. See OP 13.00 *Signing of Legal Documents and Effectiveness of Loans and Credits* ¶ 2. Both standard and special conditions of effectiveness must be complied with before the legal agreements for a loan can be declared effective.

21 For an explanation of these and other terms used in policy-based lending, see OPCS, *Good Practice Note on Results in Development Policy Lending* (June 2005).

22 See *Good Practice Note on Designing Development Policy Operations*, supra n. 16 at 24.

23 See OPCS, *Programmatic Adjustment Lending Retrospective* ¶¶57-63 (January 2004).

24 See *Development Policy Lending Update*, supra n. 12 at 29 (stating that the negative list serves as a self-implementing "code of conduct" for borrowers which could trigger the Bank's enforcement of its legal remedies only in exceptional cases); and Ibrahim F.I. Shihata, *Interim Report on Adjustment Lending – Statement by Mr. Shihata*, SecM88-322, ¶¶ 8-9 (March 23, 1988) reprinted in Shihata, *Legal Papers,* supra n. 5

III. CONDITIONALITY AND THE ARTICLES OF AGREEMENT

18. Except for minor references to "suitable conditions" of Bank loans and "terms" of IDA financing, the concept of "conditionality" is not explicitly discussed in either IBRD or IDA's Articles.[25] Nor do the Articles specifically require, control, or regulate "conditionality," as that term is used in policy-based lending (discussed in Section II of this paper). Instead, as successive General Counsel have emphasized, the Articles cannot be subject to a strict literal reading. The Articles must receive a great measure of purposive interpretation to reflect the Bank's changing role as a development institution.[26]

19. ***Special Circumstances Provision.*** As noted earlier, policy-based lending takes place under the "special circumstances" exception in the Articles. This exception allows the Bank to depart in "special circumstances" from its traditional practice of making or guaranteeing loans only for specific projects.[27] This general rule regarding Bank financing for projects (and the "special circumstances" exception) is listed as one of the "conditions" on which the Bank may make loans and guarantees.[28]

20. The scope and extent of the "special circumstances" provision is not defined in either institution's Articles. This omission was, in some respects, a deliberate one. The framers sought to give the Bank wide discretion in responding to a special circumstance.[29] Through 60 years of the practice, the "special circumstances" provision has been interpreted in an evolving manner.

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at 377-378 ("*Statement on Adjustment Lending*") (noting that the negative list enables quick disbursement and efficiency, while ensuring that the development purposes of the Bank's financing are served more clearly).

25 See discussion in paragraphs 36-38 of this paper. Cf. Gold, supra n. 6 at 20-25 (noting that the IMF's Articles does not give any express guidance on what policies the Fund should encourage members to follow as part of its conditionality).

26 See *Authorized Purposes Opinion*, supra n. 5.

27 See supra n. 2.

28 See IBRD Articles, Article III, Section 4 and IDA Articles, Article V, Section 1.

29 See Henry Bittermann, *Negotiation of the Articles of Agreement of the International Bank for Reconstruction and Development*, 5 International Lawyer 76 (1971); and Shihata, *Statement on Adjustment Lending,* supra n. 24 at ¶ 3 (noting that authors of the Bank's Articles give the Board sufficient latitude in interpreting this provision).

21. As a general principle, "special circumstances" are those, which in the Board's judgment, justify a departure from the general rule that Bank loan proceeds should finance "specific projects."[30] Special circumstances are usually country-specific, related to a certain period of time, or result from a general economic situation that affects some or all borrowing countries.[31] At first, it was determined that Bank loans under "special circumstances" would be appropriate only if a country's growth prospects were seriously affected by actual or prospective external imbalances and the necessary inflow of external resources could not be mobilized through more conventional financing.[32]

22. Subsequently, the understanding of "special circumstances" evolved to justify Bank assistance where countries faced a gap in actual or anticipated external financing requirements that could have balance-of-payments or fiscal origins.[33] With the introduction of development policy lending, the "special circumstances" provision has been applied to assist a borrower in "special circumstances" address its actual or anticipated development financing requirements that may have either domestic or external origins.[34]

23. ***Link between Conditionality and Special Circumstances.*** Neither the "special circumstances" exception nor any other provision of the Articles explicitly requires conditionality for policy-based lending. However, when the Bank introduced structural adjustment lending in 1980, it made a borrower's "willingness to formulate a suitable program of structural adjustment" an important precondition for these operations. The Bank's support for a borrower's "program" was linked to various changes that a country would make in its export-import balance, policies, institutions, and investment guidelines.[35] It was envisaged that these changes or "conditions" would enable the borrower to meet its development requirements.[36]

24. As the share of adjustment lending increased, the importance of conditions associated with these operations grew.[37] Virtually every adjustment operation included a list of "conditions" of actions or measures embedded in a borrower's program that a government should take, or refrain from taking. This link between conditions in a borrower's program and

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30 *Authorized Purposes Opinion,* supra n. 5 at ¶ 7; and Ibrahim F.I. Shihata, *Project and Non-Project Financing under the IBRD Articles*, SecM-84-1053, ¶¶ 8-10 (December 21, 1984) ("*Project and Non-Project Financing*") reprinted in Shihata, *Legal Papers*, supra n. 5 at 173 (discussing the distinction between project and non-project lending, and noting that in the Bank's practice, "project lending" has used a broad definition of the term "project" to include programs where specific goods and services are allocated for well-defined purposes).

31 See *Project and Non-Project Financing*, id. at ¶ 11.

32 See Senior Vice President and General Counsel, *Legal Note on Development Policy Lending* ¶ 3 (July 26, 2004) ("*Development Policy Lending Legal Note*").

33 See id. at ¶ 4.

34 See id.

35 See id. at ¶ 2.

36 See id. at ¶¶ 12-13 (noting that the justification for Bank support lies in the policy measures and institutional changes, which the government has decided to carry out to achieve its objectives) and, see also, Memorandum from the President, *Program Lending*, R68-206, 7-11 (November 5, 1968) cited in Shihata, *Legal Papers,* supra n. 5 at 177 (emphasizing that government polices form the basis of "program loans" under the special circumstances provision and that these policies are important to the *effectiveness* and *justification* of these loans) (emphasis added).

37 See Ibrahim F.I. Shihata, *The World Bank in a Changing World* vol. 1, 59 (Martinus Nijhoff Publishers 1991) (noting that conditionality evolved from macroeconomic measures to detailed reforms affecting public administration).

the Bank's financial support has been emphasized through successive iterations of operational policy governing policy-based lending under the "special circumstances" provision.[38] Thus, through 25 years of Bank practice, conditionality involving a program of specific policy and institutional actions has become an essential aspect of policy-based lending under the "special circumstances provision."

25. ***Purposes of IDA and IBRD.*** Any activities undertaken by IBRD and IDA, including lending for specific projects or programs, including special-circumstances lending, must be in accordance with their "purposes." Article I of IBRD's Articles lists the institution's purposes and they may be summarized as follows:

(i) to assist in the reconstruction and development of members by facilitating investment for productive purposes;

(ii) to promote private foreign investment and, when private capital is not available on reasonable terms, to supplement private investment by providing, on suitable conditions, for productive purposes out of its capital or funds raised by it and its other resources;

(iii) to promote the long-range growth of international trade, and the maintenance of equilibrium in balance of payment;

(iv) to arrange loans or guarantees for projects so that the more useful and urgent projects, large and small alike, are dealt with first; and

(v) to conduct its operations with due regard to the effect of international investment on business conditions in its members.

26. Similarly, Article I of IDA's Articles enumerates IDA's purposes as follows:

> "to promote economic development, increase productivity and thus raise standards of living in the less-developed areas of the world included within [IDA]'s membership, in particular[,] by providing finance to meet their important developmental requirements on terms which are more flexible and bear less heavily on the balance of payments than those of conventional loans, thereby furthering the development objectives of [IBRD] and supplementing its activities."

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38 See *Structural Adjustment Lending Memorandum,* supra n. 7 at ¶ 2 (1980) (a precondition for structural adjustment lending is the government's willingness to formulate a suitable program of structural adjustment); Vice President and Corporate Secretary, *Bank's Lending Instruments: Conditions in Lending*, SecM85-518, 4 (April 30, 1985) (conditions in adjustment loans are based on a medium-term program of change and translate the structural reform objectives into concrete actions, to be taken during loan implementation); Operational Manual Circular 87/06 ¶8 (1987) (identification of "minimum conditions" is necessary for an adjustment operation to proceed); O.D. 8.60 ¶ 6 (1992) (adjustment lending operations seek to achieve structural changes and they range from support for macroeconomic and institutional reforms to a relatively limited set of sector-specific policy actions); Operational Memorandum from Vice President, OPCS, *Clarification of Current Bank Policy on Adjustment Lending* (1998) (structural and sectoral adjustment operations support macroeconomic and sectoral policy measures); and OP 8.60 ¶ 2 (2004) (development policy lending assists poverty reduction through a program of policy and institutional actions that promote growth, enhance well-being, and increase incomes).

27. The Articles of both IBRD and IDA require that the institutions must be guided by their respective purposes in all decisions.[39] These purposes form the principal reference points for the Bank's operations and allow it to adapt its mandate to the continuously changing environment.[40]

28. As discussed above, the Articles provide little guidance on the manner in which lending under "special circumstances" is to take place. But even in these circumstances, the Bank's operations must be in accordance with the "purposes" identified in the Articles. As a practical matter, however, the Bank enjoys a substantial degree of operational freedom in determining how it will achieve these purposes. Thus, if the Bank agrees with a borrower that certain policy and institutional actions or "conditions" are necessary in order for a policy-based loan to accomplish development purposes, these conditions may be validly justified under the Articles.

29. ***Productive Purposes Requirement.*** Among the various purposes of the Bank, the concept of "productive purposes" is seminal.[41] It constitutes an indispensable ingredient in any Bank lending operation. In a 1988 legal opinion, the then General Counsel noted that the Articles place an "overwhelming" emphasis on the concept of "productive purposes."[42] The Articles' *travaux preparatoires* reveal that this concept was especially important at the Bretton Woods Conference, which led to the establishment of the IBRD and the IMF. Delegates were very anxious to avoid the negative experiences of past international lending, where loans were manipulated for speculative purposes.[43] Thus, the concept of Bank financing for "productive purposes" was enshrined prominently in the Articles, and it has been consistently reiterated through the Bank's policy and practice over the last 60 years.

30. "Productive purposes" applies not only to regular investment or project-specific lending, but also to policy-based lending under "special circumstances."[44] Thus, all loans, credits, and grants made by the Bank must be for "productive purposes" whether they are for specific "projects" with eligible expenditures identified or for policy-based loans or programs with no specific earmarking of loan proceeds.[45]

31. As an operational matter, in the investment lending context, the Bank ensures that its "productive purposes" requirement is achieved through specific legal covenants that require the borrower to carry out a project (designed to achieve specific productive and development objectives) with due diligence and efficiency. A corresponding mechanism in policy-based

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39 See IBRD Articles, Article I and IDA Articles, Article I.

40 See *Development Policy Lending Legal Note,* supra n. 32 at ¶ 5.

41 See IBRD Articles, Article I (ii).

42 See *Authorized Purposes Opinion*, supra n. 5 at ¶ 8.

43 Id. See generally, Andreas F. Lowenfeld, *International Economic Law* 501-502 (Oxford University Press 2003) (discussing manipulative practices that distorted international finance before World War II).

44 See *Authorized Purposes Opinion,* supra n. 5 at ¶ 11. The General Counsel explained why the "productive purposes" test also applies to non-project lending under "special circumstances" as follows:

> No special circumstances can justify the use of the Bank's loan proceeds for purposes unrelated, directly or indirectly, to development or reconstruction. The argument that money is fungible and that any financing by the Bank may release equivalent funds for use by the borrower for other purposes cannot be used as a legally acceptable reason to allow the Bank to violate its mandate or act outside the scope of its Articles. Thus, Bank loans which do not purport to finance a specific project must still aim at facilitating or supporting productive purposes.

45 See *Project and Non-Project Financing under the IBRD Articles,* supra n. 30 at ¶¶ 8-10.

operations is conditionality, since it is used to further development objectives. Conditionality serves the role of a useful navigational aid to keep the borrower's development program on course to ensure its productive outcomes and objectives are achieved.[46] Thus, the careful use of conditionality in policy-based operations could be justified under the "productive purposes" test of IDA and IBRD's Articles as a means to ensure that the borrower achieves growth and sustainable reductions in poverty.

32. ***Bank Financing on "Suitable Conditions" and "Terms."*** In reciting IBRD's purposes, Article I (ii) of IBRD's Articles recognizes that the institution may provide financing for productive purposes on "*suitable conditions* (emphasis added)." Similarly, Article I of IDA's Articles declares that IDA's purposes include providing finance for its members to meet their important development requirements on *flexible and less onerous terms* than those of conventional loans (emphasis added).

33. It is evident from the context that the framers of the Articles used the expressions "conditions" and "terms" to refer mainly to financial and credit aspects of Bank financing. Yet, they chose to not expressly restrict these references to financial matters only. Therefore, these expressions offer an additional statutory basis for policy-based conditionality in the Articles.[47] Accordingly, the use of conditionality in policy-based lending as evidence of a borrower's commitment to its program of policy and institutional actions could be regarded as fulfilling the Articles' expectation that the Bank's loans are made on "suitable conditions" or "terms."

34. ***Appropriate Terms of IDA Financing.*** Article V, Section 2 (b) of IDA's Articles states that IDA may provide financing on terms that it may deem appropriate "having regard to the economic position and prospects of the area concerned and to the nature and requirements of the project." This provision does not have a corresponding equivalent in IBRD's Articles. Yet, it constitutes an additional justification for conditionality in IDA-financed development policy lending since it gives the institution broad discretion in responding to development needs. In exercising this discretion, IDA may provide development financing on the basis of the borrower's program of policy and institutional actions by treating them as conditions to ensure that IDA's financial support makes an effective development contribution.[48]

IV. CONTRACTUAL ASPECTS OF CONDITIONALITY IN LEGAL AGREEMENTS

35. This section discusses the manner in which conditionality is reflected in the Bank's legal agreements. The Bank's loan agreements set forth the principal terms and conditions of loans

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46 See *Adjustment Lending Retrospective,* supra n. 10 at ¶ 117-118 ("Conditionality thus links financial support to the implementation of a program of reforms considered critical for the country's economic and social adjustment."); and Aron Broches & Piero Sella, "International Bank for Reconstruction and Development," in *Foreign Development Lending – Legal Aspects* 86 (Seymour Rubin, ed., American Society of International Law 1971) ("the Bank is also concerned that the projects for which it lends be successfully and efficiently executed and operated so that the loan will make the maximum contribution to the economic development of the member").

47 The expression "suitable conditions" was introduced at the Bretton Woods Conference to provide flexibility in making Bank loans. See Bitterman, supra n. 29 at 72 (discussing the drafting history of this provision).

48 See *Report of the Executive Directors on the Articles of Agreement of the International Development Association* ¶ 14 (January 26, 1960).

provided by the Bank to its borrowers.[49] In investment operations, the agreements describe the project objectives and components, while in policy-based operations, the agreements refer to the borrower's program supported by the loan.[50] These agreements set forth the financial terms and conditions of the loan and restrictions regarding the use of loan proceeds. They also set forth remedial measures that the Bank may take when the borrower fails to comply with loan obligations. Loan agreements are supplemented by the Bank's General Conditions, which normally contain the standard terms and conditions that apply to all borrowers. General Conditions are incorporated by reference in the legal agreements.[51]

36. ***Borrower's Program.*** Policy-based operations do not fit readily with the Bank's traditional contractual framework for investment or project-based lending. In regular investment operations, the legal agreements between the Bank and the borrower usually require that the borrower or the project implementing agency (which the borrower appoints or agrees to) *carry out* the "project" with "due diligence and efficiency" in conformity with appropriate practices. The borrower is also required to provide funds, facilities, services, and other resources. The "project" is described in the loan agreement, which sets forth the project's development objective and its various components.

37. In the case of policy-based financing, however, the focus is on the borrower's "program" of actions, objectives, and policies designed to achieve growth and sustainable reductions in poverty. This program is described in a communication from the borrower called the "letter of development policy" that is received before Board presentation. The letter summarizes the salient elements of the program to be supported by the loan and declares the borrower's commitment in executing the program.[52] On this basis, the Bank makes a loan in support of the borrower's program. As this paper noted earlier in Section III, critical conditions, which usually consist of specific policy and institutional actions, are included in the legal agreement as either

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49 As a general matter, it should be noted that the legal agreements between the Bank and its member-state borrowers are considered international agreements. See generally, Aron Broches, *International Aspects of the Operations of the World Bank*, 98(3) Recueil Des Cours 297, 353 (1959).

50 Legal Vice Presidency, *Simplification of IBRD and IDA General Conditions and Standard Legal Documents* ¶ 6 (May 5, 2005).

51 See IBRD, *General* Conditions *for Loans*, Section 7.02 (July 1, 2005) ("*IBRD General Conditions*"); and IDA, *General Conditions for Credits and Grants*, Section 6.02 (July 1, 2005) ("*IDA General Conditions*").

52 See OP 7.00 *Lending Operations: Choice of Borrower and Contractual Agreements* ¶ 16.

prior actions or as special conditions of effectiveness or, when multiple tranches are involved, as prior actions and tranche-release conditions.[53]

38. Unlike a borrower's legal obligation to carry out a specific project in the investment lending context, its commitment to execute its program has been generally regarded as not contractually enforceable under the legal agreement for the operation.[54] As the former General Counsel stated:

> The Bank cannot deem the failure of a borrowing government to take these measures as a violation of the government's legal obligations under the loan agreement, as the latter does not obligate the borrowing country to carry out those measures.[55]

39. There are several reasons for such a position. First, it is within the sovereign prerogative of a member state whether or not to take the critical policy and institutional actions that constitute conditions for disbursing a policy-based loan. Some of these actions may entail delicate and sensitive domestic considerations and involve internal decisionmaking, including parliamentary approval. It would be unwise and inappropriate for the Bank to be seen as influencing or interfering with these processes. Second, treating a borrower's failure to implement a policy action as a breach of a legal obligation owed to the Bank could create significant financial repercussions for the country. Aside from negative consequences for future Bank and other donor support, the borrower's standing in international financial markets could be seriously affected.[56]

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[53] Another important difference between policy-based lending and project or investment-type operations relates to the linkage between disbursements and the use of funds for specific expenditures. In the case of projects, as a general rule (and with the limited exception of special account advances) the Bank reimburses the borrower only for eligible expenditures incurred for goods, works, and services. The legal agreement usually defines the types of eligible expenditures. See generally, OP 12.00, *Disbursements* ¶ 1. In policy-based lending, however, funds are not linked to any specific imports or other expenditures. See *Development Policy Lending Update, supra* n. 12 at ¶ 26 (citing 1996 operational memorandum on simplifying disbursements in structural-adjustment loans). Disbursements are made against compliance with critical conditions (policy and institutional actions), satisfactory implementation of the program, and the maintenance of a satisfactory macroeconomic policy framework. The borrower commits not to use funds for ineligible expenditures. See OP 8.60 ¶ 18. The loan agreements for policy-based operations contain a negative list of expenditures (such as military items, precious stones, etc.) that cannot be financed under the operation. But it is important to note that this negative list is not regarded as a part of a policy-based operation's "conditionality." It is a standard fiduciary requirement that applies across all such operations.

[54] See Acting Senior Vice President and General Counsel, *Bangladesh – Jute Sector Adjustment Credit – Request for Inspection – Legal Opinion* ¶ 2 (January 29, 1997) ("*Bangladesh Inspection Opinion*").

[55] See Ibrahim F.I. Shihata, *The World Bank Inspection Panel: in practice* 39 (2nd ed., World Bank, 2000). See also, *Conditionality and Unconditionality*, supra n. 5 at 438 (noting, in the context of Fund operations, that a borrower does not violate any legal obligations to the Fund if it departs from policies in support of which the Fund made its resources available); and "Legal Aspects of Foreign Development Lending," in Rubin, supra n. 46 at 211 (Bank General Counsel's oral intervention noting "severe limitations" on trying to bind a country with regard to general policy issues).

[56] Commercial banks sometimes include cross-default provisions in their loan agreements with foreign sovereigns that are triggered if these borrowers are no longer eligible to either use the IMF's general resources or, in some cases, to make withdrawals of loans from the Bank. . See Lee Buchheit and Mark Walker, "Legal Issues in the

40. Therefore, since the introduction of structural adjustment lending, it has been the Bank's practice not to regard prior actions or tranche-release conditions as imposing binding legal obligations on the borrower. But, as this paper discusses below, if the borrower fails to carry out these conditions, the Bank may have certain remedies with respect to disbursements.

41. ***Obligation to Consult the Bank on Program Changes.*** Legal agreements for development policy operations require the borrower to exchange views from time to time with the Bank on the progress in carrying out the program and any tranche-release conditions that are listed in the legal agreement. A specific provision is also included that requires the borrower to "exchange views" with the Bank "on any proposed action" that would have the effect of "materially reversing the objectives of the program, or *any action taken* under the program" (emphasis supplied).

42. In multitranche operations, this obligation extends to exchanging views on actions relating to tranche-release conditions as well. Therefore, although a borrower cannot be legally required to carry out an agreed policy-based program, it is under a legal obligation to consult the Bank if it seeks to make any changes or revisions to *any* action or condition—taken or to be taken—that is a part of the program supported by the financing.

43. ***Tranche-Release Conditions.*** Disbursements in a development policy operation may consist of a single or multiple tranches.[57] The initial tranche is released upon effectiveness.[58] Subsequent tranche releases depend on whether the Bank determines that three basic requirements are met. First, the Bank must be satisfied with the borrower's progress in carrying out the program. Second, the macroeconomic policy framework of the borrower must be satisfactory. And third, the borrower must have taken specific policy and institutional actions (known as "specific tranche-release conditions") listed in a schedule to the agreement.[59]

44. ***Approvals of Tranche-Releases and Waivers.*** After the loan agreement is declared effective, the Bank engages in effective supervision to verify whether the program conditions are complied with.[60] For each tranche after the first one, the Bank prepares a tranche-release document that discusses the status of the program supported under the operation. On this basis, Bank management may approve a tranche release. However, any waivers to tranche-release conditions must be approved by the Executive Directors.[61] If no waivers are granted, and the Bank is not satisfied that the borrower has met the three requirements listed above, it may give notice to the borrower specifying the actions that should be carried out. If the borrower does not

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Restructuring of Commercial Bank Loans to Sovereign Borrowers", in *Sovereign Lending: Managing Legal Risk* 139-157 (Michael Gruson & Ralph Reisner eds., Euromoney Publications 1984).

57 See OP 8.60 ¶ 14. Whether to include tranches or not depends on a number of factors, including the country's policy environment and capacity, its financing requirements and other available financing, and the content and phasing of the program being supported by the development policy operation. See id. Tranching ensures compliance with any yet-to-be-taken condition in a program agreed with the Bank. However, if all conditions are met in advance, then there is no need for tranching.

58 In some cases, release of the first tranche may be delayed after effectiveness where the borrower elects to pay the front-end fee from its own resources and fails to do so.

59 See OP 8.60 ¶ 14.

60 See OP 8.60 ¶ 16.

61 See id. ¶ 31. Procedures for tranche releases, including waivers of conditions, are set out in BP 8.60 ¶¶ 19-21.

take satisfactory steps to resolve the matter within 90 days, the Bank may give notice to cancel the remaining undisbursed loan amount or a portion of it.

45. ***Bank's Options when Borrower Fails to Comply with Conditions.*** The Bank's practice not to contractually require a borrower to carry out its program does not imply that the Bank has no legal options if the borrower fails to implement agreed-upon actions. The circumstances, however, are somewhat limited for the Bank to exercise these remedies.[62] And where grounds exist for the Bank to invoke its remedies, it is not legally obliged to exercise them.[63] The Bank exercises its judgment in determining whether to invoke a remedy taking into account the circumstances of the case, the purposes under the Articles, its own interests, and the interests of its members as a whole.[64] Resort to either remedy does not imply that either the prior actions or the tranche-release conditions are legal obligations of the borrower.[65]

46. ***Failure to Consult Bank before Taking Inconsistent Actions after Disbursement.*** As noted above, the borrower is under an obligation to exchange views with the Bank on any proposed actions, after the loan has been disbursed, that materially reverse the program's objectives or any actions taken under it, including any tranche-release conditions. Thus, in either a single-tranche or a multitranche operation, if the borrower proceeds to take such action without exchanging views with the Bank, the Bank may, after a 60-day notice period, accelerate the maturity of the loan under the General Conditions for the borrower's default in performing an obligation (the requirement to exchange views with the Bank) under the loan agreement.[66]

47. ***Failure to Comply with Tranche-Release Conditions.*** If the borrower fails to take actions specified for tranche releases, the Bank has the following options:

(a) The Bank is not obliged to release the tranche to the borrower.

(b) If the Bank determines that the failure is due to a situation that shall make it improbable that the program (or a "significant part" of the program) will be carried out, it may suspend—in part or in full—the

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62 See World Bank Inspection Panel, *Report and Recommendation on Request for Inspection - Argentina Special Structural Adjustment Loan* ¶ 17 (December 16, 1999) ("*Argentina Adjustment Inspection Request*").

63 See *Structural Adjustment Lending Memorandum,* supra n. 7 at ¶ 13 (stating that the Bank would not suspend disbursements in structural adjustment loans or take any other remedial actions open to it without being certain that a default, in the sense of failure to take an agreed action, was a significant one). Note that, besides these remedies, a standard provision in legal agreement for a policy-based loan allows the Bank to request the borrower to refund any loan amounts used to finance excluded expenditures on the negative list.

64 See Senior Vice President and General Counsel, *Remedies Available to the Bank and IDA under the Loan and Credit Agreements on the Sardar Sarovar Projects*, Sec M-92-0994, IDA/SecM02-291 ¶ 18 (July 16, 1992) (the "*Sardar Sarovar Opinion*") reprinted in Shihata, *Legal Papers,* supra n. 5.

65 See *Argentina Adjustment Inspection Request,* supra n. 62 at 46-47 n35 (management's response discussing legal opinions for the Bank in an adjustment operation).

66 See *IBRD General Conditions*, Section 7.07 (b) and *IDA General Conditions,* Section 6.06 (b) and *Bangladesh Inspection Legal Opinion,* supra n. 54 at ¶ 3. Acceleration implies that the Bank may declare the principal of the loan then outstanding to be due and payable immediately together with the interest and other charges thereon. In practice, however, this option (acceleration of maturity) has never been exercised by the Bank. See *Sardar Sarovar Opinion*, supra n. 58 at ¶ 8.

borrower's right to withdraw the loan proceeds.[67] Note, however, that if the Bank suspends disbursements under this option, it could also suspend the borrower's right to withdraw under all other loans to the borrower financed by the Bank (including those for investment projects).[68]

(c) If the borrower's right to withdraw loan proceeds remains suspended for a continuous period of 30 days, the Bank has the option to cancel the undisbursed amount of the loan or credit.[69]

(d) If, by the expected date of compliance, a tranche-release condition is not satisfied, the Bank may review the situation and provide notice to the borrower on the actions that should be carried out within 90 days. If the borrower fails to carry out these actions within this period, the Bank may cancel the undisbursed amount of the loan.

48. ***Inconsistent Actions after Tranche-Release Conditions are Satisfied.*** Once the borrower complies with the tranche-release conditions, the Bank usually notifies the government that it is entitled to make a withdrawal. However, if the government takes an action inconsistent with the program between the date of this notice and the actual date of withdrawal, the Bank may exercise its rights to suspend disbursements under option (b), above.[70] However, this remedy is ineffective if the borrower's default takes place after all tranches have been released. Generally, however, the borrower's failure to fulfill a single, isolated condition, or a few minor ones, has not been used as a basis for invoking suspension.[71]

V. OTHER LEGAL AND POLICY ASPECTS OF CONDITIONALITY

49. This section summarizes certain legal and operational considerations that arise from the Bank's practice in using conditionality that were the subject of legal opinions or advice in the past.

50. ***General Consistency with Articles and Applicable Operational Policies.*** As an operational principle, conditionality is carefully conceived, drafted, and negotiated balancing the legitimate objectives of the borrower and the purposes of the Bank. Agreed conditions in a program are in accordance with the Bank's purposes and other provisions of its Articles. Conditions in policy-based lending are confined to only those aspects that are essential for the

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67 See *IBRD General Conditions*, Section 7.02 and *IDA General Conditions* Section 6.02. Loan agreements for policy-based loans have traditionally included language to the effect that the Bank may suspend the loan if "a situation has arisen which shall make it improbable that the program, or a significant part thereof, will be carried out." Note that this situation does not have to involve an act or omission on the borrower's part. It could arise due to a natural disaster, such as an earthquake, which may be beyond the borrower's control.

68 See OP 13.40, *Suspension of Disbursements* and BP 13.40 (prescribing detailed steps to be taken if the Bank is to suspend disbursements to a borrower). In single-tranche loans, this option is of limited utility because the loan is usually disbursed after the legal agreements are declared effective, unless the loan contains a deferred-drawdown option.

69 See *IBRD General Conditions*, Section 7.03 and *IDA General Conditions*, Section 6.03. Cancellation procedures are found in OP 13.50 and BP 13.50.

70 See *Bangladesh Inspection Opinion*, supra n. 54 at ¶ 3.

71 See *Argentina Adjustment Inspection Request*, supra n. 62 ¶¶ 13-18 (management's response discussing scope of Bank's legal options in adjustment operations).

operation to meet its objectives. Conditions are reasonable in number, and realistic and reasonable in substance and in their time horizon, and monitorable.[72] Task teams should ensure conditionality does not violate the Articles' prohibitions on political matters discussed below and is consistent with the applicable operational policies and procedures of the Bank.[73]

51. ***Political Activities Prohibition.*** The Bank's Articles contain two general prohibitions on the Bank's involvement in "political" matters. These prohibitions should be respected when designing and formulating conditionality in policy-based operations.

52. The first prohibition is found in Article IV of IBRD's Articles. The Article forbids the Bank from interfering in a borrower's political affairs and from using political considerations in its decisions. It reads:

> The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decision by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I.[74]

53. A similar prohibition is also found in IDA's Articles.[75] This prohibition really consists of two separate rules. First, the Bank must not interfere in a country's domestic politics or foreign partisan affairs. Second, the Bank's financing decisions cannot be influenced by the "political character" of a member country.[76] The second prohibition in the Articles requires the Bank to make arrangements to ensure that its funds are used only for the purposes of the loan and without regard to political or other noneconomic influences.[77]

54. As a consequence of these prohibitions, conditionality in Bank-financed operations is based on economic, rather than political, considerations.[78] In making decisions, the Bank views these factors impartially to achieve its purposes.[79] However, this position does not imply that the Bank should completely ignore political implications or consequences when deciding whether to lend to a borrower.[80] In the policy-based lending context, especially, the Bank needs relevant

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72 See OP 7.00 ¶ 14 (prescribing standards for covenants or undertakings in Bank contractual documents).

73 Note that certain operational policies do not apply to development policy lending. The Inspection Panel has received at least three requests for inspection alleging that specific policy-based programs have not complied with the Bank's operational policies. See also, Shihata, *Inspection Panel*, supra n. 49 at 39-42 (discussing whether Inspection Panel has jurisdiction over policy-based operations).

74 See IBRD Articles, Article IV, Section 10.

75 See IDA Articles, Article V, Section 6.

76 See Roberto Danino, *Legal Aspects of the World Bank's Work on Human Rights: Some Preliminary Thoughts* 10-11 (New York University School of Law, March 1, 2004).

77 See IBRD Articles, Article III, Section 5 (b) and IDA Articles, Article V, Section 1 (g).

78 See generally Senior Vice President and General Counsel, *Prohibition of Political Activities under the IBRD Articles of Agreement and its Relevance to the Work of the Executive Directors*, SecM87-1409 (December 23, 1987) reprinted in Shihata, *Legal Papers, supra* n. 5 at 239; and *Issues of 'Governance' in Borrowing Members – the Extent of Their Relevance Under the Bank's Articles of Agreement*, SecM91-431 (April 12, 1991) ("*Governance Opinion*") reprinted in Shihata, *Legal Papers, supra* n. 5 at 244.

79 See generally, Yozo Yokota, "Non-Political Character of the World Bank," *20 Japanese Annual of International Law* 39-64 (1976).

80 See *Legal Aspects of Human Rights*, supra, n. 76 at 10.

knowledge of the political situation in the country involved and to appreciate underlying social and cultural factors to ensure that conditionality is suitable to country circumstances and the loan will achieve its objectives.[81]

55. But as the then General Counsel cautioned in 1992, any attempt, however simplistic, to introduce political transformation through policy-based lending in the form of politically motivated conditionality might contravene the Articles.[82] Thus, conditionality is carefully formulated based on strong economic justifications supported by rigorous analytic underpinnings to avoid any criticism that conditionality could be perceived as blatant or disguised political interference.

56. ***Legal Due-Diligence.*** Adequate constitutional, legal, administrative, and regulatory due diligence is necessary in designing conditionality. The Bank should consider whether a borrower (acting through its designated ministries or agencies) is reasonably capable of carrying out agreed conditions in a program. In the case of subnational policy-based operations, this due diligence should include determining whether the relevant subnational units (acting through their agencies and institutions) have the constitutional and legal competence to undertake actions and measures that are included as loan conditions. The Bank investigates whether the conditions can be undertaken by executive action or if they need parliamentary or legislative approval.[83] Thus, in the past, Bank teams have been advised to be cautious in requiring a borrower's government to complete actions that may be well beyond its control.[84]

57. ***Conditions Affecting Constitutional Provisions.*** Similarly, Bank teams have been cautioned against including conditions that are contrary to express provisions in the borrower's constitution. A constitution is at the core of a state's sovereignty and nationhood. Therefore, a borrower cannot be expected to violate its own constitution when undertaking a program.[85]

58. ***Borrower Ownership.*** Strong borrower ownership of conditionality is an important requirement for a policy-based operation. Therefore, while it is important to undertake adequate

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81 See Senior Vice President and General Counsel, *Prohibition on Political Activities in the Bank's Work*, SecM95-707, 18-20 (July 12, 1995) reprinted in Shihata, *Legal Papers,* supra n. 5 at 219.

82 See *Governance Opinion*, supra n. 78 at IV (2).

83 See Operations Evaluation Department, *Economies in Transition* 22 (2004) (finding inadequate understanding of economic and political situation in Ukraine that resulted in parliament rejecting a negotiated loan).

84 For instance, it may be unrealistic to include a dated condition in a policy-based operation requiring the government to sell an enterprise. This could result in a forced sale or a sale at any price that could be unfair to the seller. However, if the privatization is one of the loan's principal purposes, the actual sale of the enterprise may be made a tranche-release condition. The borrower would be entitled to receive the financing proceeds only after the condition is fulfilled. See Shihata, *Legal Papers,* supra n. 5 at 384.

85 For example, some constitutions forbid the privatization of certain public enterprises. Thus, the Bank may not ask a government to violate its own constitution by undertaking privatization of state-owned enterprises. Note, however, that a state may not defend its actions or any course of conduct that are inconsistent with its legal agreements by relying on its domestic law or legal system. See Vienna Convention on the Law of Treaties, Article 46 (1), (May 23, 1969). This principle is incorporated in the Bank's loan agreements with its borrowers by a provision in the General Conditions, which makes the rights and obligations of both parties (the Bank and the borrower) valid and enforceable "notwithstanding" any contrary law of a state or political subdivision. See *IBRD General Conditions,* Section 8.01 and *IDA General Conditions,* Section 7.01.

consultations with various nongovernmental groups and other actors,[86] the final decision on what conditionality to include in an operation is taken together with the government.[87]

59. ***International Trade Negotiations.*** In recent years, multilateral, regional, and bilateral trade negotiations have considerably transformed the landscape of international trade. These negotiations often involve vital economic and political interests that influence relative bargaining positions among nations. It would be unwise for the Bank to be seen as interfering in these sensitive processes. Thus, in the past, the Bank has generally avoided requiring borrowers to eliminate or reduce trade measures that are already the subject of sensitive multilateral or bilateral negotiations. It could also be perceived as very unfair if the Bank is regarded as inequitably restricting a borrower's ability to use its legitimate remedies under international trade law, such as antidumping duties, to deal with problems such as dumping.[88]

60. ***Conditions Requiring Enactment of Laws or Regulations.*** Policy-based operations often require the enactment of a law or a regulation as part of the agreed reform program. As an initial consideration, it might be preferable to avoid including a condition in a policy-based loan explicitly requiring a borrower to *enact* a law. Instead, the condition could require the borrower to ensure that draft legislation is submitted to its parliament for approval. Requiring the passage of a law could cause problems between the executive and legislative branches of a borrower's government because this condition assumes that the legislature will inevitably approve the envisaged legislation, thus taking its action for granted.

61. However, there are often situations in policy-based lending where legislative action is absolutely essential to the viability of a program. In these cases, the Bank may consider asking for this action to be taken before Board presentation as a prior action or as a tranche-release condition.[89] It may be preferable if conditions and tranche-release conditions avoid setting any specific dates for legislative action for such stipulations could be perceived as interfering with sovereign legislative prerogatives. Another reason why dated conditions should be avoided is that if, whatever reason, the necessary actions are taken after the required date, a waiver of the condition would be necessary.

62. ***Careful Formulation and Drafting.*** Policy and institutional action that the Bank and the borrower agree as important ingredients for a policy-based operation is reflected in that operation's program matrix and in the government's letter of development policy.[90] Those actions that are critical are normally incorporated as precisely worded conditionality in the legal

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86 See OP 8.60 ¶ 6 (encouraging consultations with and engaging key stakeholders in the process of formulating a country's development strategies).

87 See Senior Vice President and General Counsel, World Bank, , *Legal Note on Indigenous Peoples,* ¶ 22 (April 8, 2005) (noting that, under the Bank's governance structure, member governments play a critical role in making decisions regarding Bank Group financing).

88 See Shihata, *Legal Papers*, supra n. 5 at 388-390 (memorandum from the Vice President and General Counsel to the Loan Committee on December 19, 1994 relating to a proposal requiring Senegal to cap its antidumping duties).

89 See OP 7.00 n.14 (legislative steps to be undertaken are normally described in the letter of development policy, but may also be part of the specific actions incorporated in the loan agreement such as conditions of Board presentation or conditions of disbursement of particular loan tranches).

90 Neither the CAS nor the Board's discussion on it should be used as an opportunity to add "additional conditionality" on a borrower. See Shihata, *Legal Papers,* supra n. 5 at 687.

agreement between the Bank and the borrower (or the project implementing entity, as the case may be) as prior actions, special effectiveness conditions, or tranche-release conditions. The language used in the legal agreement to describe any of these conditions is clear and cogent.[91] It is important to synchronize this description in the legal agreement with the text in the program document, the letter of development policy, and the policy matrix to avoid any ambiguity among these documents.[92] If the borrower's program is supported by other donors, and includes actions to be taken that are outside the Bank's operational mandate, it may be necessary to clearly identify those actions supported by the Bank's operation through arrangements or understandings with other donors and the borrower.[93]

63. Tranche-release conditions explain precisely the measures expected from the borrower, and, to the extent possible, the yardsticks by which those measures will be monitored. These conditions are formulated in a manner that will avoid, rather than invite, future disputes.[94] Besides the conditions included in the legal agreement, the other elements or ingredients of the operation, including triggers, milestones, and outcomes indicated in the policy matrix or program document, are described precisely to avoid any confusion.

64. ***Cross-Conditionality and Coordination with Other Donors.*** Cross-conditionality has been a fairly contentious topic since the Bank introduced structural adjustment loans in 1980.[95] As a preliminary matter, it is important to understand what "cross-conditionality" means. As used in the Bank and Fund's literature, this term implies:

> A situation where one institution refers in its agreement with a borrower to conditions required by the other institution and considers noncompliance with these conditions vis-à-vis the other institution an event of default under its own agreement. This type of conditionality would theoretically happen, in the case of the Bank, if it included in a loan or guarantee agreement a reference to a condition or conditions required by the Fund and deems noncompliance with such conditions vis-à-vis the Fund a default under the Bank agreement.[96]

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91 See OP 7.00 ¶ 14.

92 See World Bank Inspection Panel, *Report and Recommendation on Respect for Inspection – Papua New Guinea Governance Promotion Adjustment Loan* ¶¶ 23-24 (May 28, 2002) (citing management response to inspection request in adjustment operation acknowledging that the program matrix did not accurately reflect actions set out in the letter of development policy).

93 A division of focus among the donors may also be spelt out in the letter of development policy itself. It is not legally appropriate, however, for other donors to co-sign the legal agreement between the Bank and the borrower.

94 See Shihata, *Legal Papers,* supra n. 5 at 382.

95 See generally, Polak, supra n. 4 at 488.

96 Mechanics of a cross-conditionality may vary depending on the circumstances. As the General Counsel explained:

> Cross-conditionality could be drafted so as to automatically trigger remedies or to simply give the institution requiring it the right to take remedies against the borrower. In the Bank's loan agreements for projects co-financed by others an "optional cross-default clause" is often included. According to such clause, the Bank considers default in payment to another co-financier as an event which gives the Bank the right to take the remedies available to it in case of default in payment to the Bank.

65. Executive Directors of the Bank and the Fund decided in 1989 to avoid cross-conditionality.[97] It was felt that, as separate institutions, each entity should stipulate its own conditions without referring to those of the other.[98]

66. Although, as a strictly legal matter, the Bank and the Fund avoid cross-conditionality, the Bank's policy-based programs do take into account the Fund's satisfaction with the macroeconomic framework in the borrowing country. Thus, as the then General Counsel cautioned in 1992, the "reality of this situation" should not be ignored in a meaningful discussion of cross-conditionality.[99] A situation of cross-conditionality should also be distinguished from parallel conditionality, where two or more creditors stipulate the same conditions. In these cases, the conditions of the Bank are very similar to those of the Fund. But they do not cross-reference each other. Thus, if there was a default it would be under the conditions stipulated by the Bank, not by cross reference to a condition made by the Fund.

67. Avoiding cross-conditionality does not imply, however, that the Bank may not cooperate or coordinate its policy-based lending operations with other multilateral, regional, or bilateral donors, including the Fund. In the case of other international organizations, such cooperation is even recognized in the Articles of the Bank.[100] Thus, in the context of development policy lending, the Bank collaborates with other development partners, including the IMF, in preparing development policy operations,[101] and seeks to "harmonize" its conditions for a policy-based loan with them in consultation with the country.[102]

Senior Vice President and General Counsel, *Bank-Fund Coordination – Questions in Respect of the Recent Note on Collaboration Regarding the States of the Former Soviet Union*, SecM92-0640, 8-9 (May 14, 1994) ("*Questions on Collaboration*") reprinted in Shihata, *Legal Papers, supra* n. 5 at 715.

97 See *Bank-Fund Collaboration in Assisting Member Countries*, R89-45, 8 (March 31, 1989) cited in Shihata, *Legal Papers*, supra n. 5 at 784.

98 See OP 8.60 ¶ 13.

99 See Senior Vice President and General Counsel, *Questions on Collaboration*, supra n. 96, at 9-10

100 See IBRD Articles, Article V, Section 8 (Bank may cooperate with any general international organization and may consider these organizations' views when making decisions on applications for loans or guarantees relating to matters directly within the competence of that organization); and IDA Articles, Article VI, Section 7 (the Bank may enter into cooperation arrangements with other international organizations).

101 See OP 8.60 ¶ 7.

102 See OP 8.60 ¶ 13.

REVIEW OF WORLD BANK CONDITIONALITY
BACKGROUND PAPER 3

RECENT TRENDS AND PRACTICES

OPERATIONS POLICY AND COUNTRY SERVICES
WORLD BANK

ABBREVIATIONS AND ACRONYMS

CPIA	Country Policy and Institutional Assessment
DPL	Development policy lending
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IEO	Independent Evaluation Office
IMF	International Monetary Fund
LICUS	Low-income countries under stress
MDG	Millennium Development Goal
OD	Operational Directive
OED	Operations Evaluation Department
OP	Operational Policy
OPCS	Operational Policy and Country Services
PEM	Public Expenditure Management
PIN	Public Information Notice
PRGF	Poverty Reduction Growth Facility
PRSC	Poverty Reduction Support Credit
SMP	Staff Monitored Program
VAT	Value Added Tax

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REVIEW OF WORLD BANK CONDITIONALITY: RECENT TRENDS AND PRACTICES

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2. ***Number of Conditions.*** The number of conditions in World Bank policy-based loans has sharply declined to about one-third of its level a decade ago, from 33 in FY95 to 12 in FY05. This declining trend has been observed across all of the Bank's Regions and in all types of borrowing countries, without any discernable difference in the number of conditions between IBRD borrowers and IDA borrowers.

3. ***Benchmarks.*** At the same time, the use of policy benchmarks in Bank operations has increased in recent years, most importantly in programmatic operations in IDA countries (mainly in the form of Poverty Reduction Support Credits). The increase in benchmarks reflects a greater alignment of policy-based operations with overall government programs with a broader sectoral coverage.

4. ***Aggregate Bank-Fund Conditionality.*** There has been an overall reduction of critical conditions and aggregate conditionality in Bank- and Fund-supported programs, with a strong impact of streamlined conditionality by the Bank in middle-income countries and a greater focus by both institutions on areas of their core expertise. There is no discernable evidence of a systematic gap in covering key areas of the country policy dialogue.

5. ***Performance.*** Bank policy-based lending continues to be selective in favor of better performers, with 68 percent of lending going to above average performers. Loans to better performing countries have the same or greater number of conditions and benchmarks as those for lower performers.

6. ***Content of Conditions.*** Bank-supported policy-based operations have moved away from a focus on stroke-of-the pen short-term reforms in the 1980s to address economic distortions toward complex medium-term institutional second-generation reforms. The content of conditionality has strongly emphasized improvements in public sector governance (including public expenditure and public financial management). It also places a greater emphasis on social sectors. At the same time, the emphasis on financial sector and private sector development issues has declined. Reforms have moved away from state enterprise privatization and toward improvements in the business environment.

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[1] See *Review of World Bank Conditionality: Issues Note* (CODE2005-0002), January 11, 2005.

7. ***Use of Conditionality.*** The use of conditionality varies by sector and by country. The most frequently used type involved conditions focused on policy decisions. There is an increasing share of process-type conditions, particularly in IDA countries with below average performance, where the bulk of the Bank's program focuses on public expenditure and fiduciary reforms.

8. ***Quality and Compliance.*** Policy-based operations seem to increasingly meet their development objectives. OED evaluations indicate that satisfactory outcome scores for policy-based lending increased from 60 percent in the 1980s to 68 percent in FY90–94, then rose to 82 percent in FY00–04. Most ex ante conditions in World Bank policy-based loans have been met.

9. ***Results Focus of Policy-Based Operations.*** A recent trend in policy-based operations is their increased focus on medium-term development objectives, such as targets set in development programs and poverty reduction strategies. The impact of these loans is evaluated increasingly on the basis of medium- and longer-term outcomes instead of exclusively relying on implementation of policy actions (inputs) and achievement of some outputs.

REVIEW OF WORLD BANK CONDITIONALITY: RECENT TRENDS AND PRACTICE

I. INTRODUCTION

1. This paper on the findings of a review of recent trends in World Bank conditionality is one of the series of background papers prepared in response to the Development Committee's request in its October 2004 meeting to review the Bank's policy and practice on conditionality and to "report on the continued efforts by the Bank and the Fund to streamline their aggregate conditionality." The objective of the review is to document the evolution of the Bank's approach to conditionality, take stock of experience, and take a fresh look at the Bank's practices of conditionality. This paper addresses (a) the number of conditions in World Bank policy-based loans; (b) their thematic content; (c) the relation of conditionality with lending approaches and design; and (d) the types of conditions used. It also examines Bank-Fund aggregate conditionality.

2. ***Conditions and Benchmarks.*** In addition to conditions—policy actions that are deemed critical for achieving the intended outcomes of the program and that are included in the legal agreement as condition for disbursement of a loan, credit, or grant[1]—the paper takes stock of benchmarks. Benchmarks represent progress markers for the implementation of the program and can be actions or outcomes expected to be achieved over the period of the program. They are not legal conditions for disbursements of Bank loans or grants and cannot hold up Bank disbursements if not carried out. However, they are sometimes perceived by clients and observers as closely related to Bank conditions, because they define the focus of the Bank's policy involvement.

3. ***Types of Conditions.*** Conditions typically focus on policy design, decision, implementation, outcomes, and the macroeconomic policy framework:

- *Process or design* conditionality includes the preparation or issuance of action plans, papers, studies, surveys, reviews, timetables, methodologies, guidelines, or operational manuals;
- *Policy or decision* conditionality includes the adoption, entry into force, or enactment of laws, decrees, directives, amendments, or regulations by parliament or congress; approval or establishment of informal and formal rules, procedures, staffing and system requirements, frameworks, or draft laws and amendments by government;
- *Implementation conditionality* includes the implementation or operationalization of government programs, initiatives, strategies, pilots, procedures, rules, laws, codes, regulations, decrees, functions, or units, and capacity-building programs;

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1 As laid out in more detail in the paper on modalities of conditionality, the Bank also requires the borrower to maintain a satisfactory macroeconomic policy framework and assurance that, overall, the program is being implemented in a satisfactory manner. See *World Bank Review of Conditionality: Modalities of Conditionality* (SecM2005-390/1), July 7 2005 [Background paper #1 of this volume].

- *Outcome* conditions relate specifically to institutional performance rates or coverage or implementation rates, and have seen limited use; and

- *Macroeconomic* conditions include specific conditions on macroeconomic and debt management and fiscal sustainability. In addition to the operational policy requirement of an adequate macroeconomic policy framework whenever a development policy operation is disbursed, loans may involve specific economic management conditionality related to achieving or maintaining a satisfactory macroeconomic program, as deemed necessary by the Bank.

The combination of these types of conditions often depends on country circumstances, country performance, and program content. For instance, conditionality in low-income countries (LICs) typically focuses more process conditions than in middle-income countries (MICs). In the same vein, public sector governance conditionality tends to be more process oriented than conditionality in the financial sectors and private sector development (PSD), which tend to be more about policy implementation.

4. ***Forms of Conditions.*** Conditions can take different forms. *Prior actions* represent policy actions that the country agrees to take before Board approval of the loan or grant and are appropriate when upfront implementation is deemed as critical for the success of the program. *Tranche release conditions* are the conditions contained in the legal agreement of multitranche loans for the disbursement of subsequent tranches. *Regular tranche conditions* have a target date attached whereas *floating tranches* do not fix the timing of implementation in advance. Finally, within programmatic operations (see below), *triggers* are the expected prior actions of the next operation in the programmatic series. These expected actions form the basis for the Bank's decision to proceed with the next operation. However, in contrast to tranche release conditions, triggers are not part of the legal agreement and are adaptable to take into consideration a changing environment and new information. Thus, triggers turn into conditions only if they are retained as prior actions for a follow-on programmatic operation.

5. ***Types of Tranches.*** In *single-tranche* operations, the Bank provides its financial support once the loan becomes effective and with the signing of the loan. The country has to fully meet the loan conditions before it is presented to the Board. In *multitranche loans*, the Bank provides its financial support typically in two or three stages or tranches, which are disbursed as program conditions are met. The conditions for each tranche are specified at the beginning of the operation and are part of a well-defined medium-term policy program. The multitranche approach is appropriate when the details of key steps in a medium term policy program are well understood.

6. ***Programmatic Lending.*** Programmatic lending has become the predominant design approach to policy-based lending in recent years. In *programmatic loans,* a series of loans are framed within a medium-term policy program, where there is a clear expectation about how the series of subsequent operations will proceed in terms of the timing, policy steps, and amount associated with each operation. In each programmatic operation, the country and the Bank agree on a limited set of prior actions associated with that operation as well as on the triggers or expected prior actions of the next operation within the series. The programmatic approach allows flexibility to adjust to new information and changing country circumstances during implementation and to change in scope of the operation over time. Almost all programmatic loans are single-tranche operations.

7. ***Data Sources.*** The data on specific conditions and benchmarks presented below in this paper are drawn from the Bank's ALCID database (Adjustment Lending Conditionality Database). ALCID contains some 18,000 loan conditions and over 10,000 benchmarks for all 695 policy-based loans approved between FY80 and FY04. (Where possible, this paper includes the experience with loans approved during the first three quarters of FY05. However, FY05 findings should be treated with caution as a number of policy-based loans are missing from the analysis. An attempt will be made to include Q4 FY05 loans in the analysis for the final report.) The conditionality database classifies each condition and benchmark into two broad groups: (a) by thematic and sector classification, and (b) by conditionality type. This review will use the thematic codes to analyze some of the content of loan conditions.[2] Except for the section on aggregate Bank-Fund conditionality and unless otherwise specified, the paper analyzes conditions on a per loan basis, in contrast to conditions per program-year or per tranche.

8. ***Country Groupings.*** This paper groups countries (see Table 1) in accordance with the FY05 Strategy and Finance paper:[3] (a) investment-grade IBRD countries, (b) core IBRD countries, (c) blend countries, (d) core IDA countries, and (e) low-income countries under stress (LICUS).[4]

9. ***Limitation of Coverage.*** Although this paper summarizes the outcomes and results described by Implementation Completion Reports (ICRs), it does not attempt to assess the impact of conditionality on broader outcomes and results. (It is difficult to associate the decline in conditionality or the increase in benchmarks to the improvement of outcomes and results as a whole.) Nor does it provide a definite assessment of the relevance and usefulness of Bank conditionality in promoting growth, improving social conditions, and reducing poverty.

10. ***Organization of Paper.*** Following this introduction**,** Section II provides a brief overview of conditionality trends. Sections III-VII examine patterns and trends for the different dimensions of conditionality in five different country groups, and interprets evolving practices. Section VIII reviews the trends in Bank-Fund aggregate conditionality. Section IX discusses the influence of Bank conditionality on outcomes and results. Each section contains a summary overview at the beginning to facilitate understanding of the main findings in each section.

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[2] An in-depth treatment of the content of conditionality can be found in a companion paper. See *Review of World Bank Conditionality: Content of Conditionality in Policy-Based Operations: Public Sector Governance, Privatization, User Fees, and Trade* (SecM2005-0390/5), July 11, 2005 [Background paper #6 of this volume].

[3] See *Medium-Term Strategy and Finance Paper* (SecM2005-0121), Table 1, March 15, 2005.

[4] Operational Policy 3.10 Annex C and Annex D define the eligibility criteria used in extending financing under IBRD and IDA terms. The policy also allows some IDA countries to undertake lending under IBRD terms. These are the blend countries. IBRD investment grade countries are those IBRD-eligible countries with a credit rating of "Investment Grade" by an international credit agency on the long-term foreign currency risk of the country. LICUS countries (low-income countries under stress) are countries with fragile institutions and policies, often facing conflict and post-conflict situations.

Table 1. Country Groups
China and India have been treated as separate analytic categories due to their size.

Category	Composition	Number	Population (millions - total)	GNIpc 2002 $
Investment Grade IBRD: *17 countries*	Barbados, Botswana, Chile, Croatia, Czech Republic, Estonia, Hungary, Korea Republic, Latvia, Lithuania, Malaysia, México, Poland, Slovak Republic, Slovenia, South Africa, Thailand	17	375	4,908
+	China		1,280	964
Core IBRD: *42 countries*	Algeria, Argentina, Belarus, Belize, Brazil, Bulgaria, Colombia, Costa Rica, Dominican Republic, Ecuador, Arab Republic of Egypt., El Salvador, Fiji, Gabon, Guatemala, Islamic Republic of Iran, Jamaica, Jordan, Kazakhstan, Lebanon, Former Yugoslav Republic of Macedonia, Mauritius, Morocco, Namibia, Panama, Paraguay, Peru, Philippines, Romania, Russian Federation, Seychelles, St. Kitts and Nevis, Suriname, Swaziland, Syrian Arab Republic, Trinidad and Tobago, Tunisia, Turkey, Turkmenistan, Ukraine, Uruguay, Venezuela	42	1,007	2,067
Blend[a/]**:** *14 countries*	Azerbaijan, Bolivia, Bosnia and Herzegovina, Dominica, Grenada, Indonesia, Nigeria, Pakistan, Papua New Guinea, Serbia and Montenegro, St. Lucia, St. Vincent/Grenadines, Uzbekistan, Zimbabwe	14	563	521
+	India		1,049	472
Core IDA: *38 countries*	Albania, Armenia, Bangladesh, Benin, Bhutan, Burkina Faso, Cameroon, Cape Verde, Djibouti, Ethiopia, Ghana, Guyana, Honduras, Kenya, Kiribati, Kyrgyz Republic, Lesotho, Madagascar, Malawi, Maldives, Mali, Mauritania, Moldova, Mongolia, Mozambique, Nepal, Nicaragua, Rwanda, Samoa, Senegal, Sri Lanka, Tanzania, Tonga, Uganda, Vanuatu, Vietnam, Republic of Yemen, Zambia	38	614	355
LICUS: *29 countries*	Afghanistan, Angola, Burundi, Cambodia, Central African Republic, Chad, Cote d'Ivoire, Comoros, Democratic Republic of Congo, Republic of Congo, Equatorial Guinea, Eritrea, The Gambia, Georgia, Guinea, Guinea-Bissau, Haiti, Kosovo, Lao People's Democratic Republic, Liberia, Myanmar, Niger, Sao Tome and Principe, Sierra Leone, Solomon Islands, Somalia, Sudan, Tajikistan, Timor-Leste, Togo	29	303	218

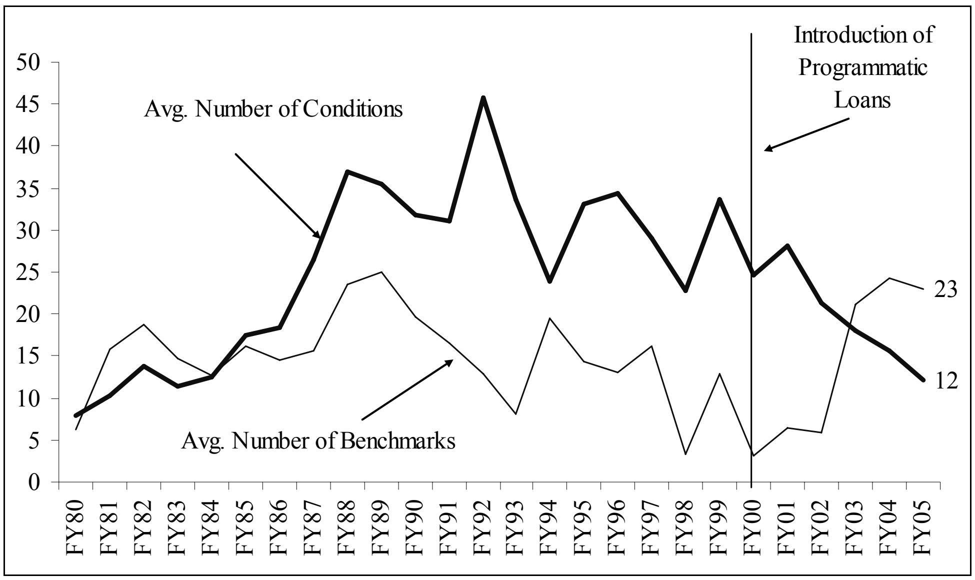
a/ Four countries in this category (Nigeria, Papua New Guinea, Uzbekistan, and Zimbabwe) are currently considered as LICUS countries (following LICUS unit monitoring tables for FY05). They were considered as Blends prior to FY05 and no-policy-based lending has been approved to any of these four countries since FY00. The last loan to Papua New Guinea was in FY00 and the last one to Uzbekistan was in FY95. There have been no policy-based loans to Nigeria or Zimbabwe in the last decade.
Source: SFR companion table to *Medium-Term Strategy and Finance Paper* (SecM2005-0121), Table 1, March 15, 2005.

II. TRENDS IN CONDITIONALITY

Overview

11. The use of conditionality in policy-based lending has been declining over the past decade, from 33 conditions on average in FY95 loans to 12 conditions on average in FY05 loans. At the same time, with the emergence of programmatic operations with a broader sectoral coverage (particularly Poverty Reduction Support Credits, or PRSCs), the use of benchmarks in program documents has increased, particularly in low-income countries, from about 14 on average in FY95 and 3 in FY00 to 23 in FY05 (see Figure 1).

Figure 1. Trends in World Bank Conditions and Benchmarks, FY80-05



Source: ALCID, World Bank.

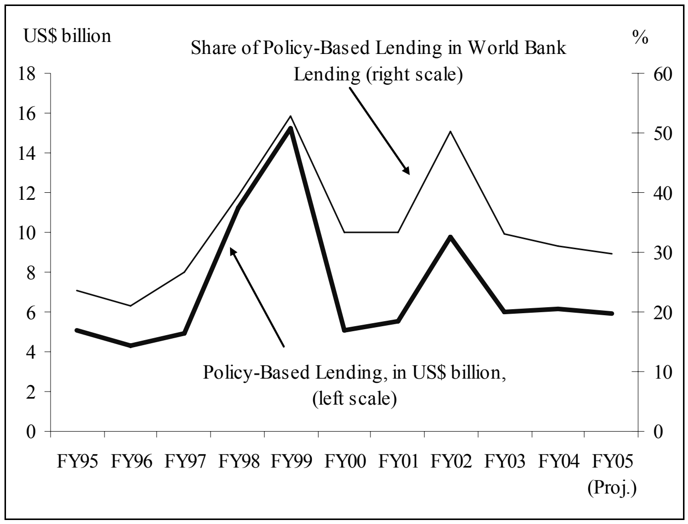
12. In addition, this section highlights the following.

- Policy-based lending represents about 30 percent of World Bank lending volumes, with significant fluctuations in response to crisis in IBRD borrowers.
- The use of specific conditions has declined in all Bank Regions.
- The use of benchmarks is driven by programmatic operations in low-income countries—notably in PRSCs.
- Thematic coverage of different sectors by conditions remained stable and it increased when taking into account benchmarks.
- Bank programs are focusing more on public sector governance and social sector issues, and less on economic management, trade, and rural and agriculture issues.
- Reforms in the business and financial sectors continue to be important areas of Bank engagement, but less through policy-based lending and conditions.
- The choice of lending instrument and sector covered has an impact on the type of condition used.
- While expected results are spelled out, the use of outcome-based conditions is negligible.

A. Lending Trends and Approaches

13. Around 30 percent of Bank lending is policy-based, but this figure typically fluctuates in response to occasional crises in IBRD countries. The share of policy-based lending peaked during the FY98-99 East Asia crisis (53 percent) and again in FY02 with the financial crisis in Turkey (50 percent). In recent years, however, the share has declined to 31 percent in FY04 and is projected to decline further to around 28-30 percent in FY05 (see Figure 2). A recent Board paper projects that policy-based lending is expected to remain essentially stable in future years.[5]

Figure 2. Trend in Policy-Based Lending, FY95-05 (Proj.)
(in US$ billion and in shares of total lending)

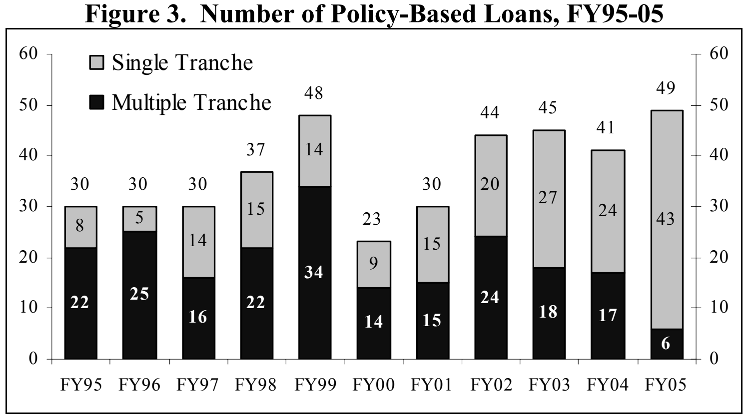


Source: SAP Business Warehouse, World Bank.

14. ***Single-Tranche Loans.*** Policy-based loans are increasingly programmatic series of single-tranche loans. Around 88 percent of the FY05 loans (6 out 49 loans) were single-tranche loans, compared with about 25 percent 10 years ago (8 out 30 loans in FY95) (see Figure 3).

15. ***Programmatic Loans.*** New approaches have transformed the nature of policy-based lending. Bank loans are increasingly supporting a unique mix of multisectoral, medium-term development programs embedded in a phased, programmatic framework. Programmatic approaches have been increasingly used in Bank operations (in investment and policy-based lending). Policy-based programmatic lending was

Figure 3. Number of Policy-Based Loans, FY95-05



Source: SAP Business Warehouse, World Bank.

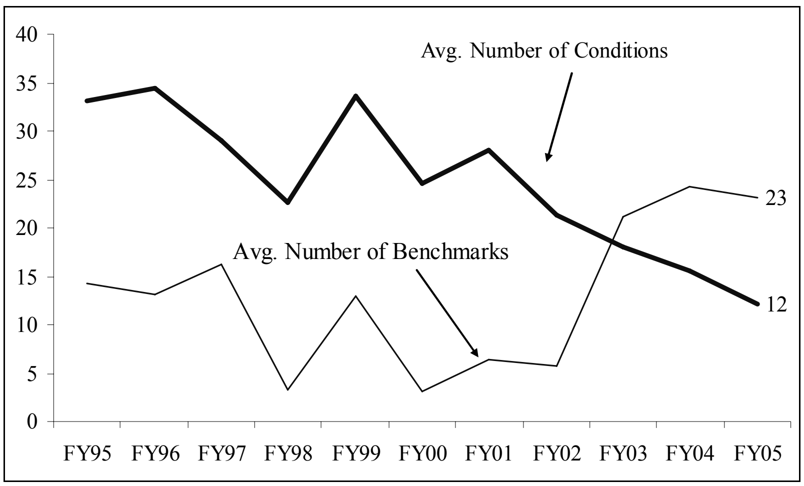
5 See *FY05-07 Outlook for the Bankwide Share of Development Policy Lending: First Annual Report* (SecM2005-0128), March 17, 2005

introduced in IBRD countries in FY00 with Thailand and in IDA countries with Uganda's PRSC. Programmatic development policy loans strive for greater country ownership and greater emphasis on outcomes and results.[6] Today, programmatic loans account for about half of all policy-based loans.

B. Number of Conditions

16. The average number of conditions used in policy-based lending has declined sharply and is now about one-third the figure of a decade ago (12 in FY05 compared to 33 in FY95). However, the use of benchmarks has increased in recent years. The average number of benchmarks used in Bank-supported programs stood at 14 in FY95. After dropping to 3 in FY00, it has increased to 23 in FY05 (see Figure 4).

Figure 4. Trends in Avg. Number of Conditions and Benchmarks, FY95-05



Source: ALCID, World Bank.

17. ***IBRD/IDA Trends.*** Loans to core IBRD countries contained a larger number of conditions than core IDA loans some years ago, but the numbers have been converging in recent years (see Figure 5). Conditions in blend countries closely follow the IDA loan patterns. Their number was high in FY00, mostly driven by a few loans.

18. ***Country Group Trends.*** The number of conditions per loan has declined over the past 10 years in all country groups (see Figure 5); however, in lower-income countries (core IDA countries and LICUS countries), the number of benchmarks increased sevenfold from around 5 per loan during FY00-02 to over 35 actions in FY04-05 (see Figure 6). There is no clear evidence on the recent trend in IBRD countries, where the use of benchmarks remains much more constrained.

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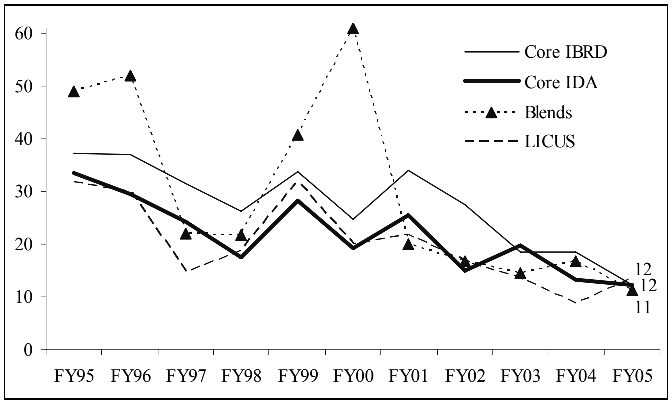
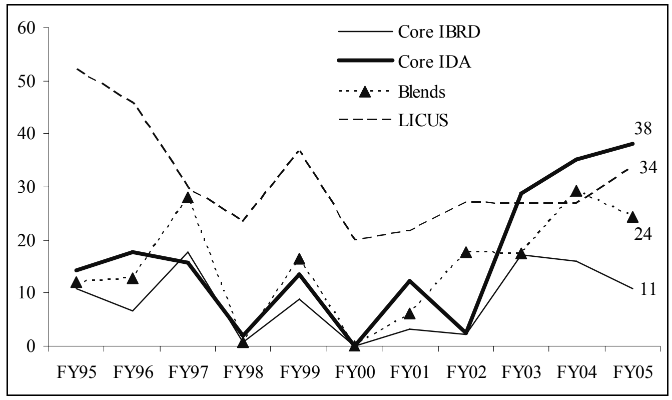
6 See World Bank, *Programmatic Adjustment Lending Retrospective*, Report 26315, OPCS, July 11, 2003; and World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM0238) OPCS, April 29, 2005.

Figure 5. Trends in Conditions by Country Groups, FY95-05



Source: ALCID, World Bank.

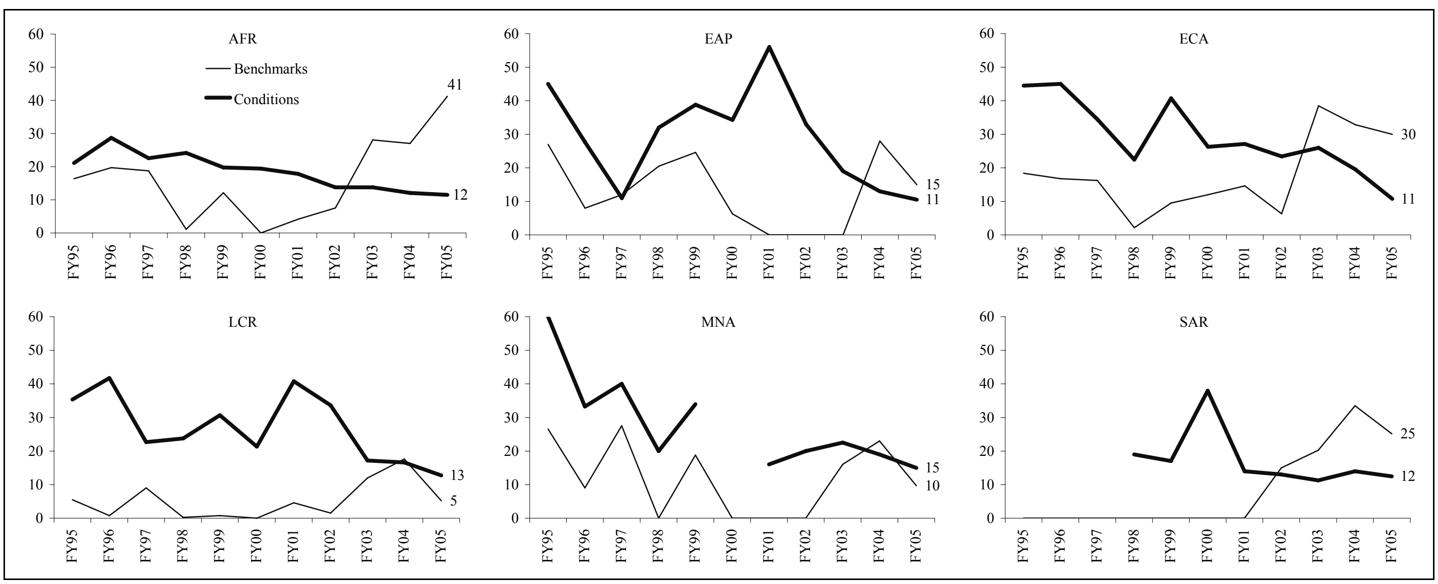
Figure 6. Trends in Benchmarks by Country Groups, FY95-005



Source: ALCID, World Bank.

19. ***Regional Trends.*** The use of specific conditions has declined in all of the Bank's Regions, although the use of conditions in each Region has varied widely (see Figure 7). The East Asia and Pacific Region had the fastest decline and the Africa Region had the lowest number of conditions. However, with the emergence of programmatic loans, all Regions showed an increase in the use of benchmarks, with the Africa and Europe and Central Asia Region leading other Regions.

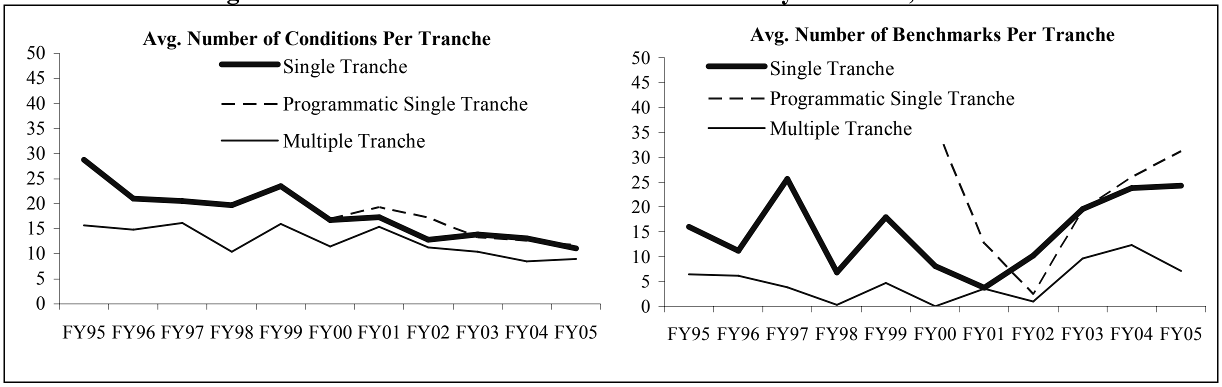
Figure 7. Trends in Conditions and Benchmarks by Regions, FY95-05



Source: ALCID, World Bank.

20. ***Single-Tranche and Multitranche Comparison.*** After correcting for the number of conditions and benchmarks on a per tranche basis, single-tranche loans have on average about the same number of conditions in FY05 as multitranche loans. However, given that single-tranche operations are the primary vehicle for multisectoral programmatic support, they tend to contain a higher number of benchmarks (see Figure 8).

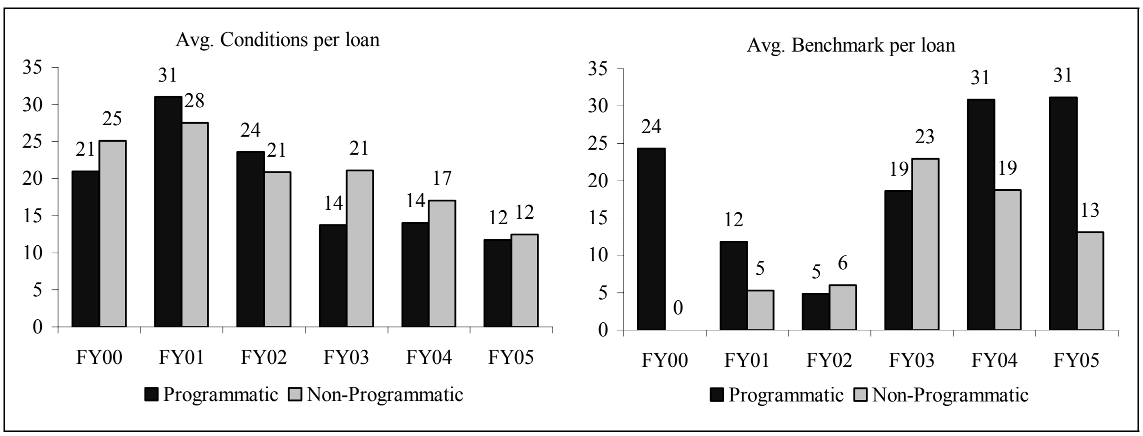
Figure 8. Trends in Conditions and Benchmarks by Tranches, FY95-05



Source: ALCID, World Bank.

21. ***Programmatic and Nonprogrammatic Comparison.*** There is a declining trend in the number of conditions per loan both in programmatic and nonprogrammatic operations. In the last five years, the average number of conditions in programmatic loans has declined from 31 to 12; the counterpart figures for nonprogrammatic loans follow closely with 28 and 12 respectively (see Figure 9). Programmatic lending has grown rapidly over the past five fiscal years, increasing its share of loans approved from 13 percent in FY00 to more than 55 percent of loans approved today.

Figure 9. Trends in Avg. Conditions and Benchmarks in Programmatic and Nonprogrammatic Loans, FY95-05



Source: ALCID, World Bank.

22. ***Benchmarks.*** The growth in programmatic lending is driving the rise in the use of benchmarks. In FY04 and FY05, there were on average 31 benchmarks in programmatic loans or double the number of benchmarks than in nonprogrammatic loans approved in FY05. A possible explanation is the multisectoral and complex nature of programmatic loans, notably PRSCs in IDA countries, which often require that documents spell out a greater number of steps as benchmarks to describe medium-term programs. The sections below on the thematic coverage of conditions and types of conditions will explore these issues in more detail.

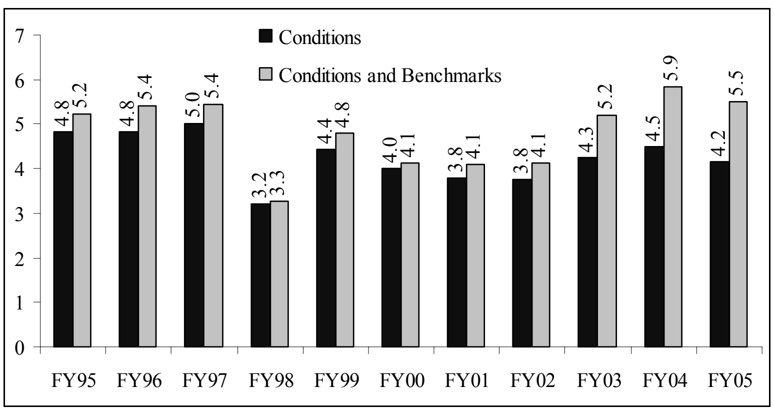
C. Thematic Coverage

23. The content of loan conditions has changed over the past two decades. Conditions in public expenditure management areas, for instance, used to focus on the preparation and

execution of yearly public investment programs, where the Bank's role was to oversee public spending with very little emphasis on the institutional setup and governance considerations. Today, much more emphasis is on the functioning of the financial management and procurement systems. These reforms follow a more sequenced approach to policy and institutional changes, and reflect the shift toward more complex and medium-term reforms. In parallel with this change in context is a change in the number of areas covered and the content of loan conditions and benchmarks.

24. ***Number of Thematic Areas.*** The number of thematic areas covered by conditions has remained approximately stable in recent years. Bank conditions focus, on average, on four thematic areas—two of the most often used are public sector governance and financial/private sector development. This finding underscores that with declining number of conditions and despite increasing multisectoral lending, the Bank has maintained thematic focus in its specific conditions. However, when adding the areas covered by benchmarks, the Bankwide average of coverage has increased in recent years, after an initial decline in the late 1990s. In FY05, for example, conditions and benchmarks of loans reflect a coverage rate of five to six areas. Again, multisectoral programmatic loans are the driving force for this development (see Figure 10).

Figure 10. Trends in Avg. Number of Themes in Conditions, FY95-05

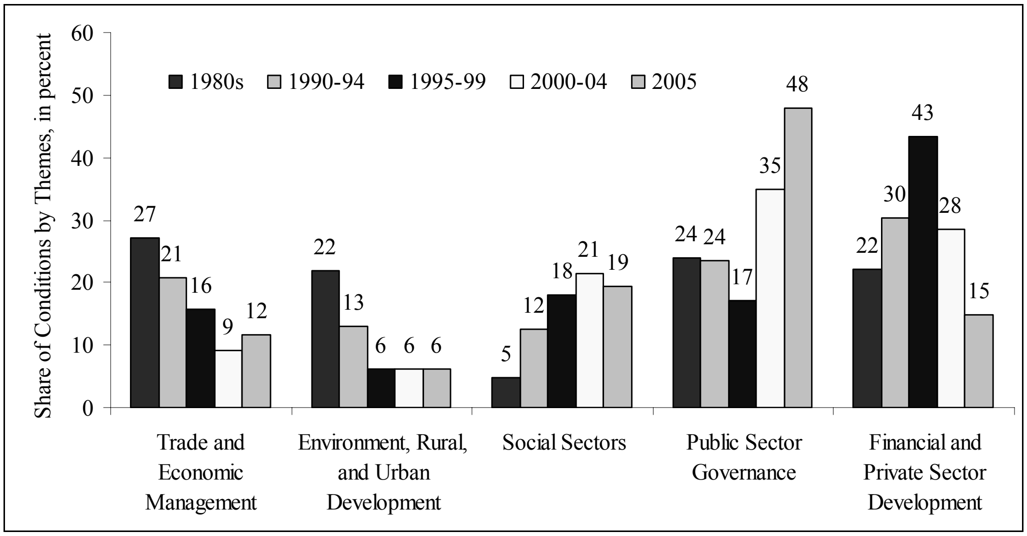


Source: ALCID, World Bank.

25. ***Sectoral Focus.*** Bank programs are focusing more on public sector governance and social sector issues, and less on economic management, trade, and rural and agriculture issues. As with trends in the number of themes in policy-based loans, the thematic classification of conditions also shows a marked shift in the focus of World Bank programs. Over the past 25 years, conditions have moved away from financing short-term macroeconomic programs toward financing complex medium-term policy and institutional reforms. For instance, the Bank is now reaching universal coverage of public sector governance issues in Bank loans. In FY97, close to 60 percent of the loans approved had conditions in public sector governance. By FY04, 93 percent of the loans approved included such conditions and in FY05 all loans had public sector governance conditions. This development is further reflected in the share of conditions going to public sector governance—it has increased from around 25 percent of loan conditions during the 1980s and 1990s to 35 percent in the early 2000s, to close to 50 percent in FY05 (see Figure 11). Another major shift has occurred on the economic management and social sector side. Close to 50 percent of conditions in loans approved during the 1980s were in economic management, trade, and rural/agriculture issues, and only 5 percent of those conditions addressed the social sectors. In recent years, however, less than 20 percent of loans had conditions in economic management, trade, and rural/agriculture issues. Social sector conditions, by contrast, reached

around 20 percent of conditions on average. Both IBRD and IDA countries experienced this change as the focus of reform programs shifted toward public sector governance and pro-poor issues of social protection, education, and health sector reforms, reflecting in part the growth of the Bank's social and poverty reduction agenda during the 1990s.

Figure 11. Trends in the Share of Conditions by Thematic Area, FY95-05



Source: ALCID, World Bank.

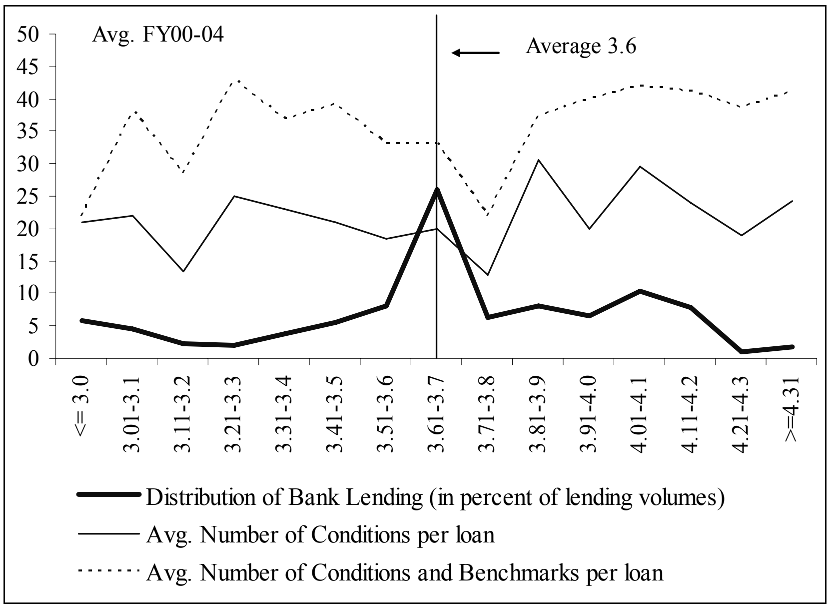
26. ***Areas of Declining Focus.*** Reforms in the private and financial sectors continue to be important areas of Bank engagement, but they are not necessarily covered by policy-based lending and conditions. During the second half of the 1990s, between 80-100 percent of loans carried conditions in one of these two sectors. By FY04, this share declined to 50 percent and in FY05 it reached 40 percent. Only 15 percent of conditions in FY05 loans were related to the financial sector and private sector development, down from 28 percent in FY00-04 on average and from 37 percent during the 1990s. Increasingly, other mechanisms and tools address policy weaknesses in these areas (for instance, IFC and the investment advisory group's investment climate assessments and IMF-World Bank financial sector assessments). Some areas of private sector development are also often being addressed under technical assistance loans.

27. ***Public Expenditure Management.*** Conditions in public expenditure management and fiduciary areas (PEM conditionality) have grown rapidly in World Bank policy-based loans. Today, around 75 percent of World Bank loans involve public expenditure management conditions, compared to 50 percent 10 years ago. This evolution reflects the considerable increase in the commitment of the international development community and governments to strengthen governance and to build and modernize public sector fiduciary institutions by focusing on improving public expenditure management, financial management, and procurement systems. PEM conditions are designed to fight corruption, strengthen fiscal governance, enhance transparency in resource allocation, and improve overall management and accountability in public expenditures—all of which are critical to social, institutional, and broad-based economic development in borrowing countries. However, this increase has been more evident in IDA countries, reflecting the need to focus on improving the quality of public financial systems in the context of increased provision of aid through budget support, including PRSCs. The share of PEM conditions in recent years has been twice as large in IDA countries (21 percent) than in IBRD countries (11 percent). More recently, in FY04, this share reached 27 percent in IDA countries and 17 percent in IBRD countries.

D. Selectivity and Country Performance

28. Recent operations continue to show selectivity in Bank lending decisions. During FY00-04, the Bank made 68 percent of policy-based lending in volume terms available to countries that rank above average on the Bank's summary performance indicator, the Country Policy and Institutional Assessment (CPIA) (see Figure 12). The number of conditions is evenly spread across the country performance scale, on average at around 22 conditions during FY00-04, with a large standard deviation of 14 conditions. Better performers are usually guided by a slightly higher number of benchmarks than lower performers.

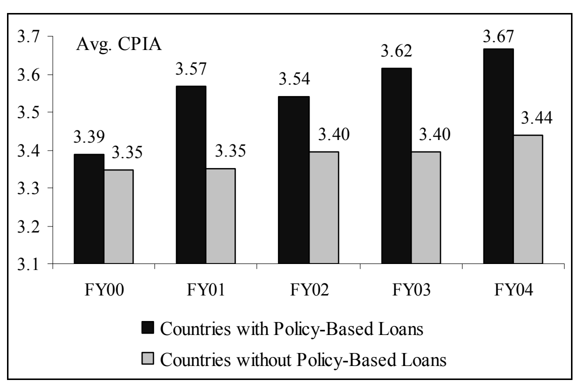
Figure 12. Share of World Bank Policy-Based Lending and Conditions by Country Performance, Avg. FY00-04



Source: ALCID, CPIA (various years), World Bank.

29. ***Growing Selectivity.*** Policy-based lending increasingly tends to go to better performers. Based on the overall average CPIA for FY00-04 (see Figure 13), the average CPIA rating for recipients of policy-based loans was 3.67, compared with 3.44 for countries that did not receive policy-based lending. The gap in the CPIA between recipients and nonrecipients has increased over FY00-04, with a declining number of countries in the lower CPIA ranges receiving policy-based lending.

Figure 13. Avg. CPIA Ratings in Countries with and without DPLs, FY00-04



Source: ALCID, World Bank.

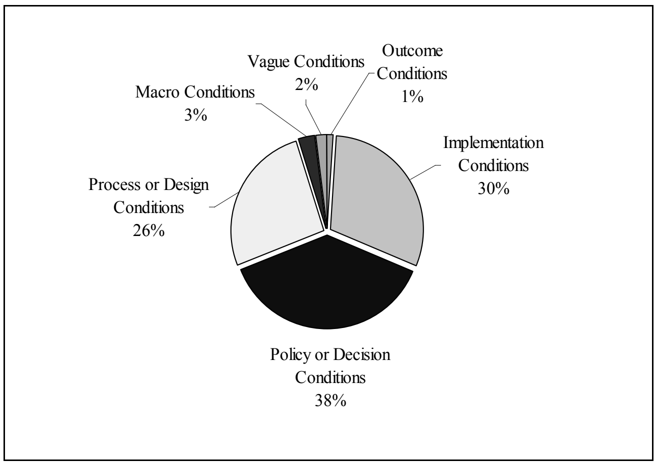
E. Types of Conditions

30. Policy-based loans contain a mix of different types of conditions. Most conditions in recent years (FY00-04) are policy or decision conditions, accounting for around 38 percent of all

conditions (see Figure 14). Implementation conditions follow with 30 percent of the conditions. Process or design type conditions represent about 25 percent of policy-based conditions, reflecting the importance of process conditions in setting the analytic and institutional frameworks for future reforms.

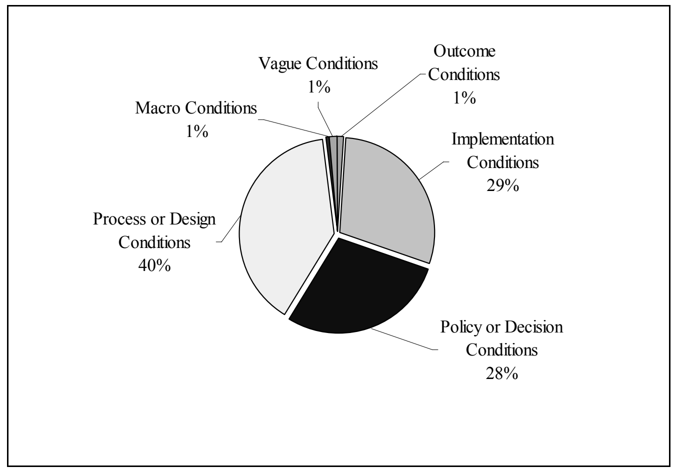
31. ***Benchmarks.*** Process or design conditions take a larger share of benchmarks (40 percent) than in the case of conditions (26 percent), reflecting the fact that conditions and benchmarks often serve different purposes (see Figure 15). Conditions are increasingly focused on critical actions, which are more likely of the decision or implementation type, whereas benchmarks focus to a larger extent on preparing future reform actions by focusing on analysis and design.

Figure 14. Distribution of Types of Conditions, FY00-04



Source: ALCID, World Bank.

Figure 15. Distribution of Types of Benchmarks, FY00-04

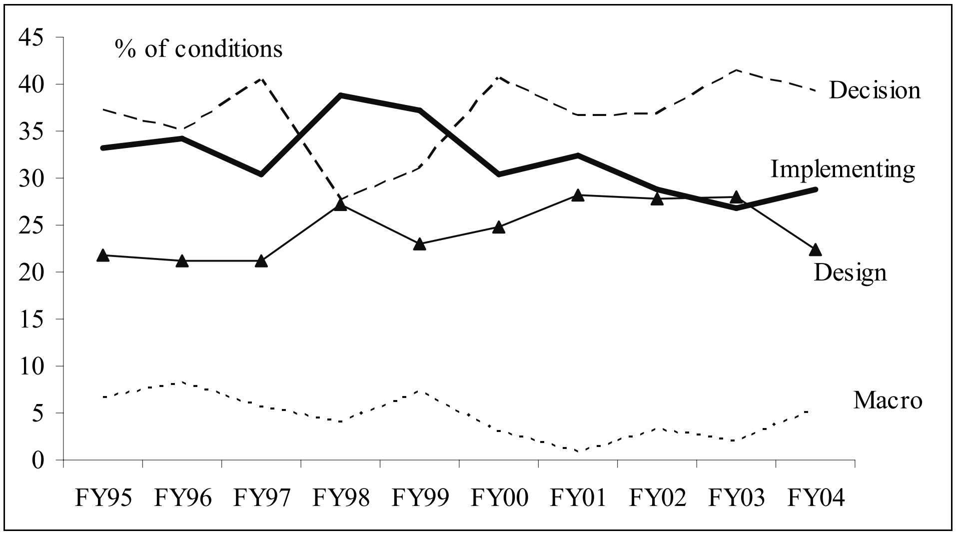


Source: ALCID, World Bank.

32. ***Outcome-Based Conditions.*** World Bank policy-based loans may have outcome-based conditions, but their share in total conditions has been very small. However, the beginning of a growth trend can be seen in loans approved recently, during FY04-05. Close to 30 percent of these loans contained at least one outcome-based condition. Where available, outcome-based conditions are found in education and health sectors, with some evidence of outcome-based conditions in regulatory and competition policies that underpin financial and private sector development.

33. ***Types of Conditions Trend.*** The type of conditions has been essentially stable over time, with some gains for decision conditions and some decline in implementation conditions. Among the six types of conditions described in Section I, decision or policy conditions have trended up slightly over the past 10 years, whereas implementation conditions have declined somewhat (see Figure 16). Overall, some decision conditions seem to be replacing implementation conditions and the rate of growth of public sector governance conditions appears to be a possible driving force in this development.

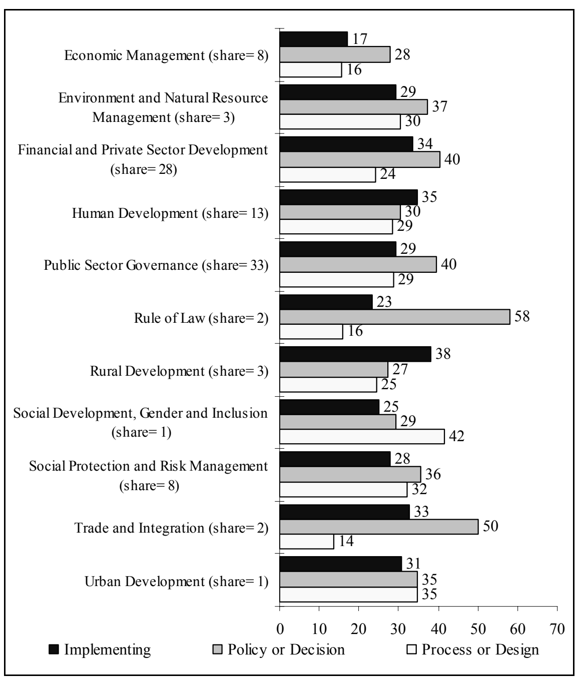
Figure 16. Trends in Types of Conditions, FY95-04



Source: ALCID, World Bank.

34. ***Design Conditions.*** Design conditions seem to be declining, but still account for a large share of conditions in certain sectors. On average, process or design conditions accounted for around 20-25 percent of all conditions during FY9504. Process or design type conditions are particularly common in public sector governance and in rural/urban development (see Figure 17).

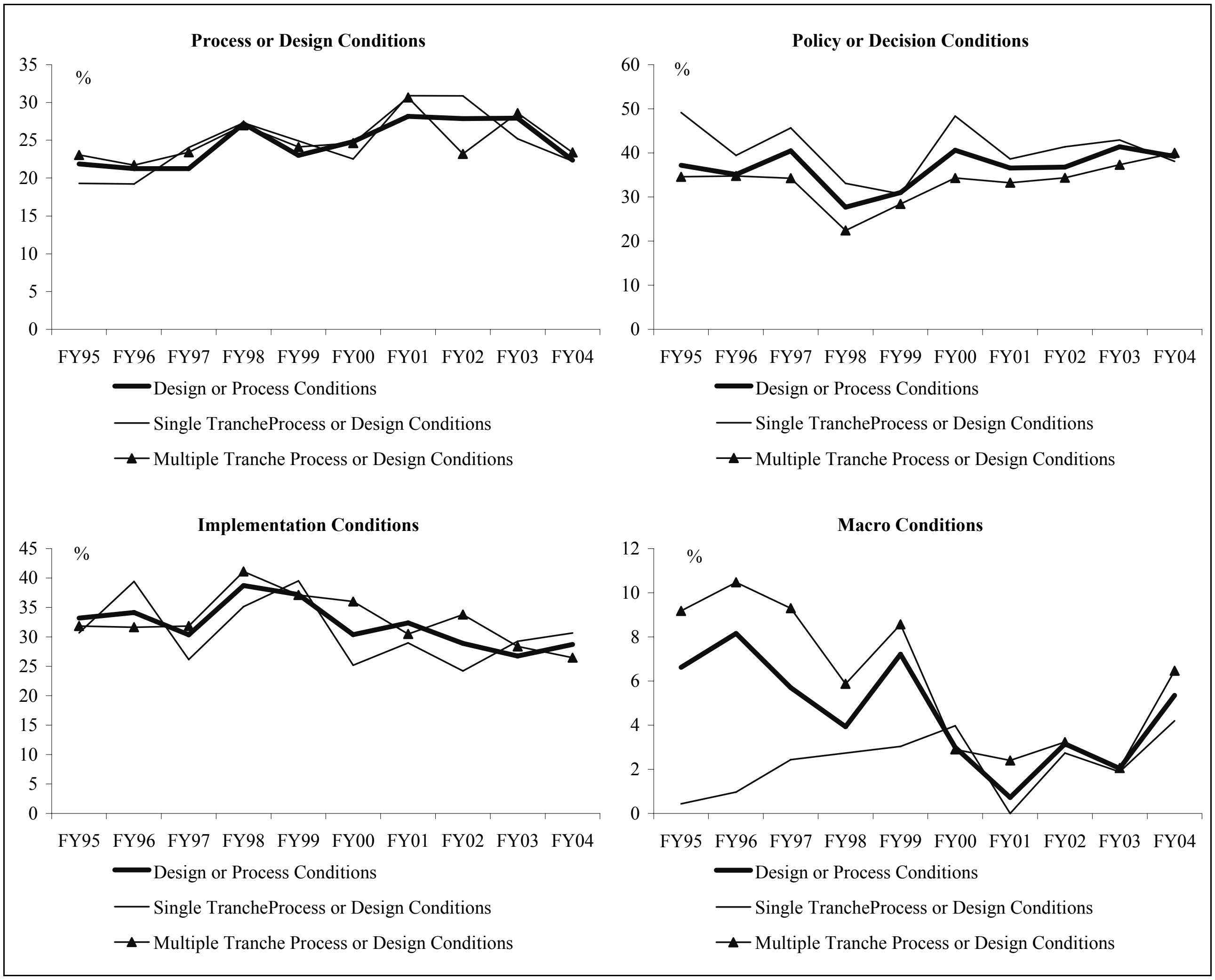
Figure 17. Types of Conditions by Themes, FY00-04



Source: ALCID, World Bank.

35. ***Instrument/Condition Link.*** The choice of lending instrument has an impact on the type of condition used. Single-tranche loans on average use about the same proportion of design conditions as multitranche loans, but single-tranche loans use a higher proportion of policy conditions (see Figure 18). Multitranche loans contain a somewhat larger share of implementation conditions than single-tranche loans. However starting in FY03, there appears to be a growing trend of implementation conditions in single-tranche loans but a decline in multitranche loans. Both instruments, single and multiple tranche loans, show a marked increase in the use of macro type conditions, reflecting an increase in the use of specific conditionality related to the general assessment of having a "satisfactory macroeconomic policy framework."

Figure 18. Trends in the Avg. Number of Conditions by Type of Condition and by Instrument, FY95-04

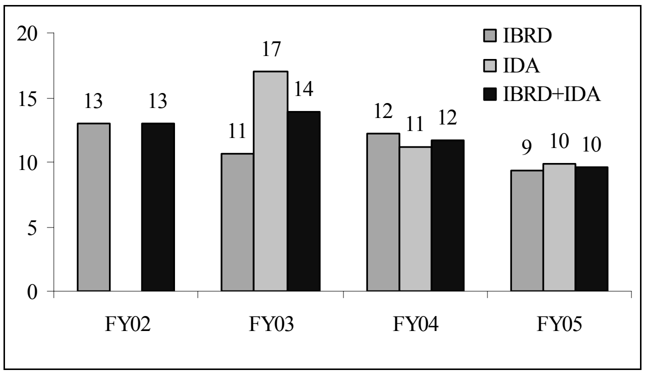


Source: ALCID, World Bank.

F. Experience with Triggers

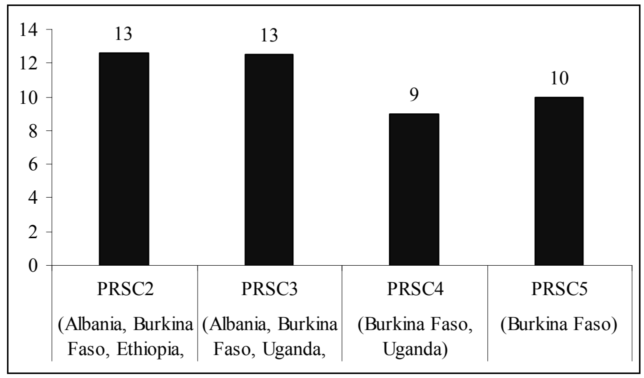
36. The average number of triggers in programmatic loans has declined, from 13-14 triggers on average in FY02-03 loans to less than 10 triggers in FY05 loans (see Figure 19). Triggers in IDA loans have declined the fastest, from 17 triggers on average in FY03 to 10 triggers in FY05 loans. The average number of triggers in PRSCs has declined as the programmatic series evolves, falling from 13 triggers on average in PRSC2 and PRSC3 loans to 9-10 in PRSC4 and PRSC5 loans (see Figure 20).

Figure 19. Average Number of Triggers for IBRD and IDA Loans, FY00-04



Source: ALCID, World Bank.

Figure 20. Average Number of Triggers by Stage in Programmatic Series

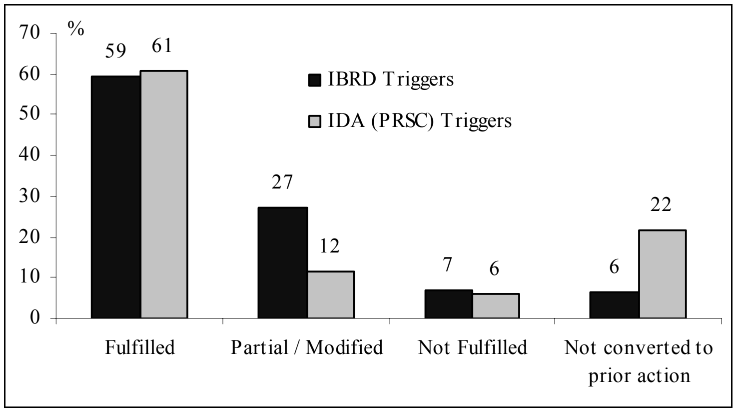


Source: ALCID, World Bank.

37. ***Trigger Flexibility.*** Within programmatic operations, triggers are the expected prior actions of the next operation in the programmatic series. These expectations form the basis for the Bank's decision to proceed with the next operation. Nevertheless, they are not included in the loan agreements, and thus are not conditions. Triggers are indicative and adaptable, to take into consideration the actual progress toward expected program results, as well as the impact on the program of exogenous factors, of implementation issues, and of design deficiencies. The critical conditions of the subsequent operation need not be identical to the triggers; they can be adapted to changing circumstances. Indeed, triggers entail considerable flexibility, because they are updated as actual prior actions and can be adapted to changing circumstances or modified for better clarity, specificity, or measurability. This flexibility allows the Bank to take into account exogenous developments, the actual pace of implementation of the policy program, the lessons arising from implementation on the ground, and any possible improvements on the original policy program.

38. ***Status of Triggers.*** Close to 60 percent of original triggers are fulfilled and converted to prior actions of the follow-on operation (see Figure 21). A smaller share of triggers are partially fulfilled or modified and then converted to prior actions; 27 percent in the case of IBRD loans and 12 percent in the case of IDA loans. However, 22 percent of triggers in IDA loans are not converted to prior actions, compared with 6 percent in IBRD loans. Some of these are replaced with new triggers and converted to prior actions and others are fulfilled but not converted into prior actions. The experience with Vietnam's PRSC2 reflects this finding, where almost all triggers were replaced with new prior actions. A smaller share of the triggers (6-7 percent) is not fulfilled and are not treated as conditions in the follow-on operation.

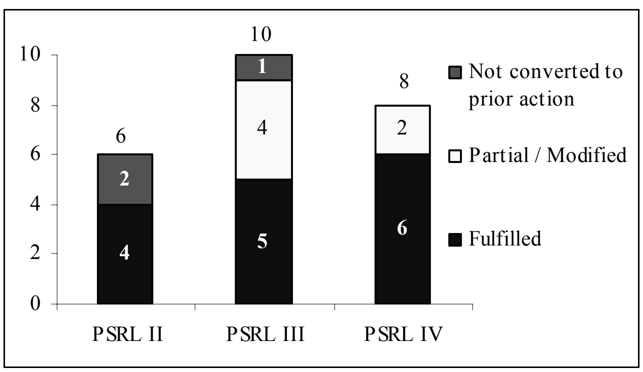
Figure 21. Status of Original Triggers (in share of triggers)



Source: ALCID, World Bank.

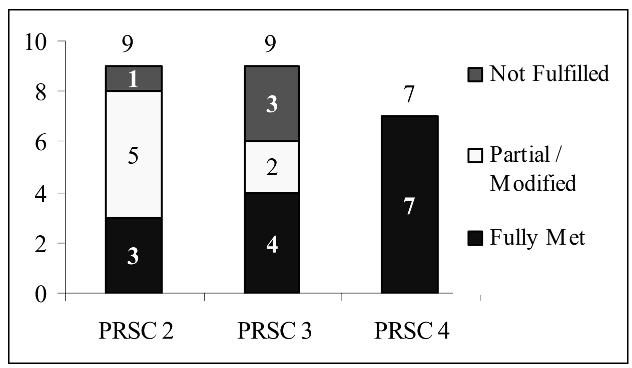
39. ***Evolution of Triggers.*** Early experience from two programmatic series in Peru and Uganda show that the proportion of triggers that are fulfilled increases in subsequent loans as triggers that are partially fulfilled, modified, or not fulfilled declines (see Figure 22 and Figure 23). These findings should be treated with caution and may not be representative for programmatic loans, as most programmatic series are in their initial stages.

Figure 22. Status of Peru PSRL Triggers



Source: ALCID, World Bank.

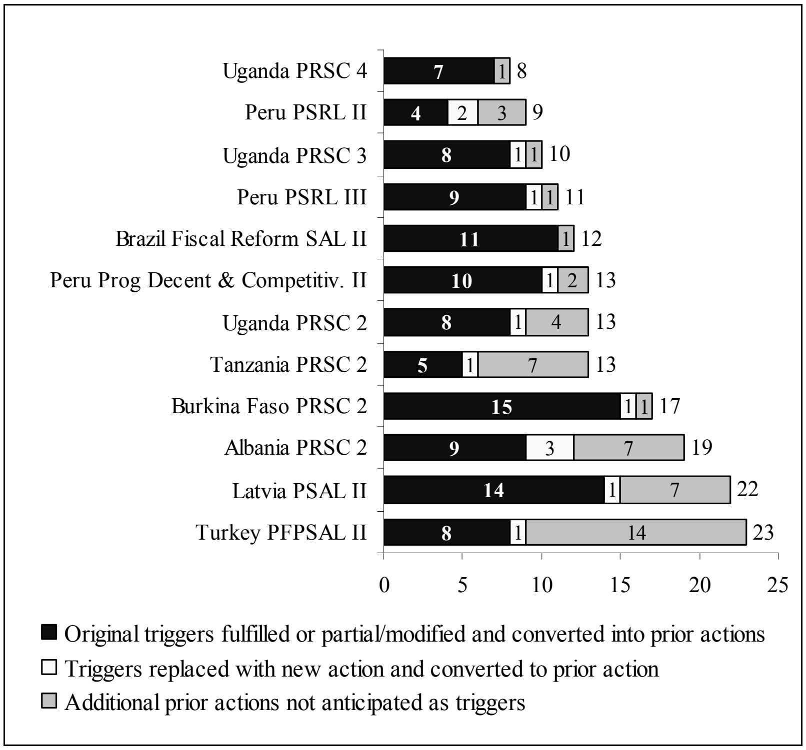
Figure 23. Status of Uganda PRSC Triggers



Source: ALCID, World Bank

40. ***Prior Actions Not Anticipated As Triggers.*** Around 44 percent of follow-on programmatic loans approved to date had additional prior actions not anticipated as triggers, and in a fifth of those new prior actions, the areas covered were new to the loan (see Figure 24). The other 56 percent of follow-on programmatic loans had the original triggers and the triggers replaced converted to prior actions.

Figure 24. Composition of Prior Actions, in Number of Conditions, Selected Loans



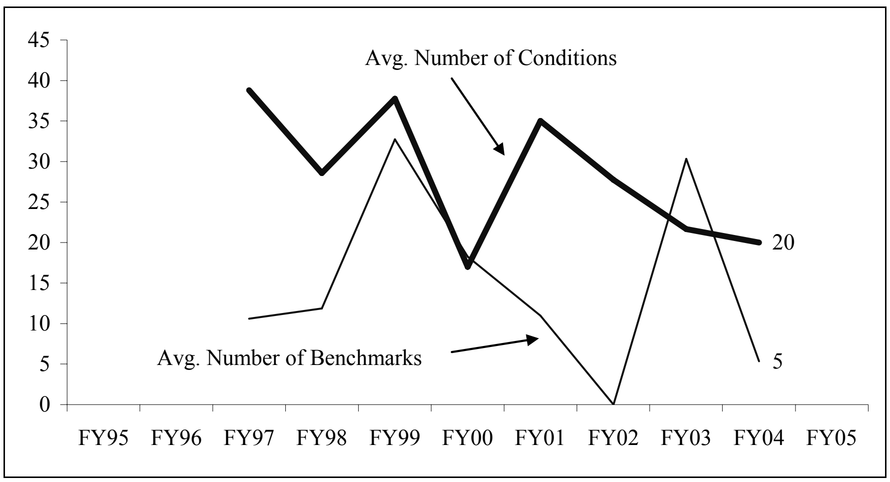
Source: ALCID, World Bank.

III. INVESTMENT GRADE IBRD COUNTRIES

Overview

41. Policy-based lending to investment grade IBRD countries has mostly constituted lending during financial crises. As a result, the sample of loans used in this section is very small and the findings of this section should be interpreted with great caution. Lending to investment grade IBRD countries has declined, although recent trends show some degree of flexibility expressed through a moderate decline of the number of conditions and benchmarks. However, the pattern is uneven and not robust enough for definitive conclusions. Overall, there has been a decline in average conditions per loan from a peak of about 40 in FY97 to about 20 in FY04 (see Figure 25). Benchmarks overall are on average a fairly unimportant tool to describe programs in investment grade IBRD countries, although they have been used in some. Other findings of this section include the following:

Figure 25. Trends in Avg. Conditions and Benchmarks in Loans to IG-IBRD Countries, FY95-05



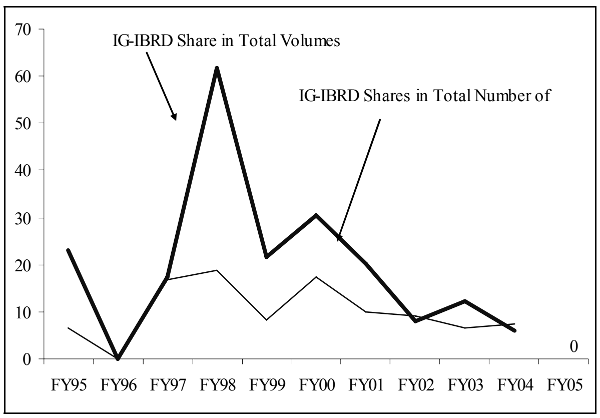
Source: ALCID, World Bank.

- The number of conditions in investment grade IBRD countries is similar to that in core IBRD countries.
- Programmatic approaches are not as widely used as in the other country groups.
- Conditions in multitranche loans (on a per tranche basis) have been declining.
- The thematic coverage of policy loans has increased, reflecting the broad engagement through policy-based lending in a very small set of countries in recent years.
- Conditions in the financial sector and private sector development areas are decreasing.
- Conditions are moving increasingly toward rule of law, anticorruption, and social sectors.
- The type of condition changes with the content of loans.
- Average conditions increase with design and policy type conditions, and decline as implementing type conditions decline.

A. Lending Trends and Approaches

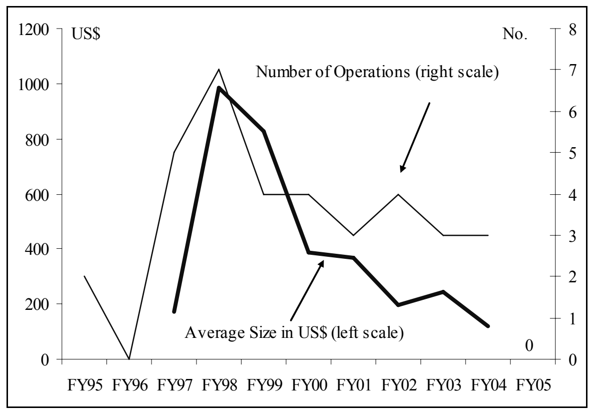
42. Lending to investment grade IBRD countries has declined from around 60 percent at the time of the East Asia crisis (mainly because of lending to Korea) to below 10 percent in recent years (see Figure 26). While the Bank approves three to four loans on average to this group of countries, the average size of these loans dropped from around US$1 billion in FY99 (during the East Asia crisis) to around US$200 million in FY05 and there is consistent decline in recent years (see Figure 27). As a result, the share of Bank policy-based lending going to investment grade IBRD countries has declined from around 18 percent in FY98 to around 5 percent in FY04, and has been focused on very few countries. (For example, Mexico received 12 of the 35 loans during the past 10 years.) There were no loans to investment grade IBRD countries in FY05.

Figure 26. Trends in the Share of IG-IBRD in Total Policy-Based Lending and in Total Number of Policy-Based Operations, FY95-05



Source: SAP Business Warehouse, World Bank

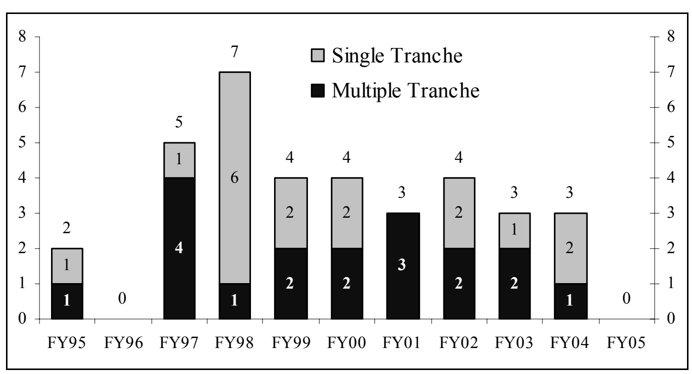
Figure 27. Trends in Average Size of IG-IBRD Loans in US$ and Number of Operations, FY95-05



Source: SAP Business Warehouse, World Bank

43. ***Instrument and Country Preferences.*** Given the small sample size, no clear preferences of investment grade countries are discernible regarding loan design. Single- and multitranche loans are equally represented, with a somewhat higher prevalence of multitranche loans following the Asian financial crisis (see Figure 28). Programmatic approaches have been used by few investment grade countries (only Latvia, Mexico, and Thailand). Loan design reflects the Bank's strategic choice in response to the country's policy environment and track record.

Figure 28. Trends in the Number of Single-Tranche and Multitranche Loans, FY95-05



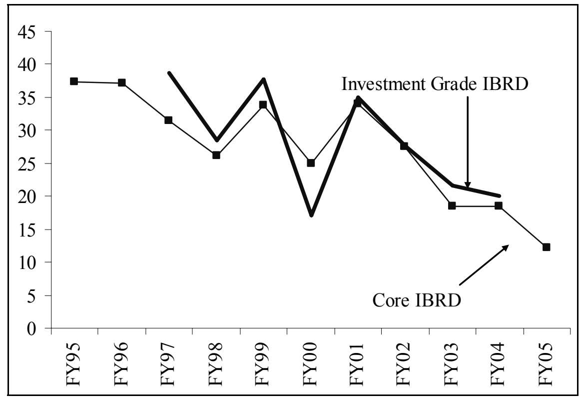
Source: SAP Business Warehouse, World Bank.

B. Number of Conditions

44. The number of conditions in loans to investment grade IBRD countries tends to be quite similar to that in core IBRD countries, except for FY99 (a crisis year) (see Figure 29).

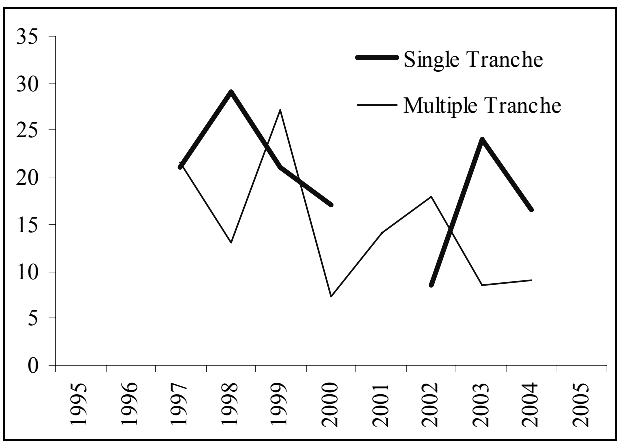
45. ***Multitranche Loans.*** Conditions in multitranche loans (on a per tranche basis) have been declining. In FY04, there were on average half the number of conditions in multitranche loans (10 conditions) compared with FY97 (see Figure 30). Benchmarks have not been used much in recent years, except in recent single-tranche programmatic loans and in crisis loans during the East Asia crisis (see Figure 31).

Figure 29. Trends in Conditions in Investment Grade IBRD Countries and Core IBRD Countries, FY95-05



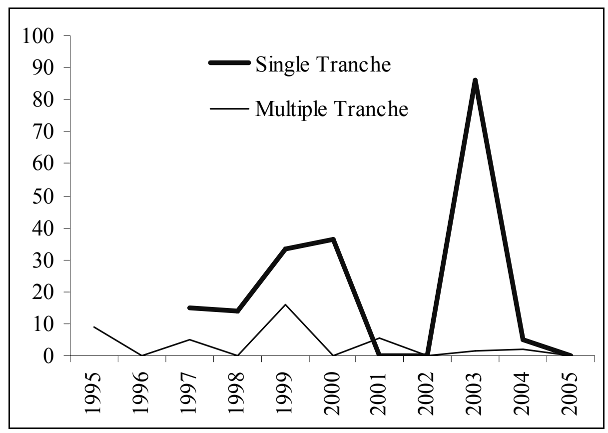
Source: ALCID, World Bank.

Figure 30. Trend in Conditions in Single and Multiple Tranche Loans [corrected for the number of conditions per tranche], FY95-05



Source: ALCID, World Bank.

Figure 31. Trends in Benchmarks in Single and Multiple Tranche Loans [corrected for the number of conditions per tranche], FY95-05

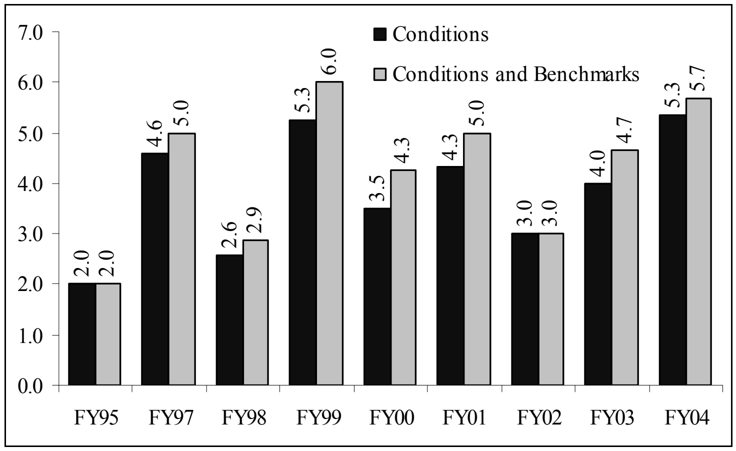


Source: ALCID, World Bank.

C. Thematic Coverage

46. Loan coverage in investment grade IBRD countries appears to be broadening in recent years. Thematic coverage almost doubled in two fiscal years; from three thematic areas on average in FY02 loans to almost six thematic areas in FY04 (see Figure 32). Programmatic loans are behind the increase in coverage trends, reflecting the multisectoral reform process that typically accompanies the programmatic approach.

Figure 32. Trends in Avg. Themes in Conditions and Benchmarks, FY95-04



Source: ALCID, World Bank.

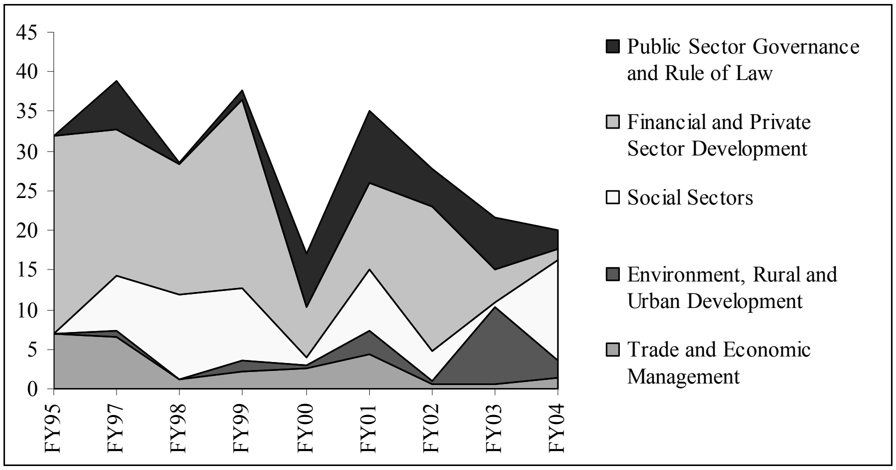
47. ***Financial Sector and Private Sector Development.*** Conditions in the financial sectors and private sector development areas are negligible in loans to investment grade clients. Judging from a small sample of loans, there are some indications these areas no longer represent critical constraints for investment grade clients. There is little evidence of the need for regulatory and competition policy conditions or for standards and financial reporting conditions (see Table 2). In addition, for the first time in a decade, in FY04, the Bank did not support a single privatization or state restructuring program in these countries—following a consistent trend of declining engagement in these areas and increased focus on public sector governance and social sector conditions. Figure 33 shows the sharp decline.

Table 2. Trends in the Share of Conditions in Investment Grade IBRD Loans by Themes, FY95-04

	FY95	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04	Avg. FY00-04
Number of Loans	**1**	**5**	**7**	**4**	**4**	**3**	**4**	**3**	**3**	**3**
Conditions - Number of Conditions	**32**	**194**	**200**	**151**	**68**	**105**	**111**	**65**	**60**	**82**
in shares of Conditions (%)										
Trade and Economic Management	21.9	17.0	4.0	6.0	14.7	12.4	1.8	3.1	6.7	7.7
Environment, Rural and Urban Development	0.0	2.1	0.0	3.3	2.9	8.6	1.8	44.6	11.7	13.9
Social Sectors	0.0	17.5	37.5	24.5	5.9	21.9	13.5	3.1	63.3	21.5
Human Development	0.0	1.0	14.0	2.6	2.9	11.4	0.9	0.0	36.7	10.4
Social Development, Gender and Inclusion	0.0	0.0	0.0	0.7	0.0	0.0	0.0	0.0	3.3	0.7
Social Protection and Risk Management	0.0	16.5	23.5	21.2	2.9	10.5	12.6	3.1	23.3	10.5
Financial and Private Sector Development	78.1	47.9	58.0	62.9	36.8	31.4	65.8	18.5	6.7	31.8
Corporate governance	0.0	0.0	2.5	4.0	0.0	0.0	2.7	0.0	0.0	0.5
Infrastructure services for private sector development	0.0	0.0	0.0	0.0	0.0	2.9	0.0	0.0	1.7	0.9
Other financial & private sector development	0.0	1.0	4.5	10.6	0.0	0.0	1.8	1.5	3.3	1.3
Regulation and competition policy	21.9	11.9	10.5	11.3	14.7	2.9	21.6	0.0	1.7	8.2
Small and medium enterprise support	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Standards and financial reporting	15.6	2.6	6.5	8.6	4.4	2.9	18.9	7.7	0.0	6.8
State enterprise/bank restructuring and privatization	40.6	32.5	34.0	28.5	17.6	22.9	20.7	9.2	0.0	14.1
Public Sector Governance and Rule of Law	0.0	15.5	0.5	3.3	39.7	25.7	17.1	30.8	11.7	25.0
Public expenditure, financial management and procureme	0.0	3.1	0.0	0.0	11.8	18.1	6.3	4.6	3.3	8.8
Administrative and civil service reform	0.0	2.1	0.0	0.0	10.3	0.0	0.9	7.7	0.0	3.8
Tax policy and administration	0.0	5.7	0.5	0.7	0.0	3.8	9.9	0.0	0.0	2.7
Decentralization	0.0	0.0	0.0	0.0	7.4	0.0	0.0	0.0	1.7	1.8
Rule of Law	0.0	0.0	0.0	1.3	1.5	0.0	0.0	1.5	5.0	1.6
Other public sector governance, accountability/anti-corru	0.0	4.6	0.0	1.3	8.8	3.8	0.0	16.9	1.7	6.2
Other accountability/anti-corruption	0.0	0.0	0.0	0.0	0.0	3.8	0.0	13.8	1.7	3.9
Other public sector governance	0.0	4.6	0.0	1.3	8.8	0.0	0.0	3.1	0.0	2.4

Source: ALCID, World Bank.

Figure 33. Trends in the Composition of Conditions by Themes, FY95-04



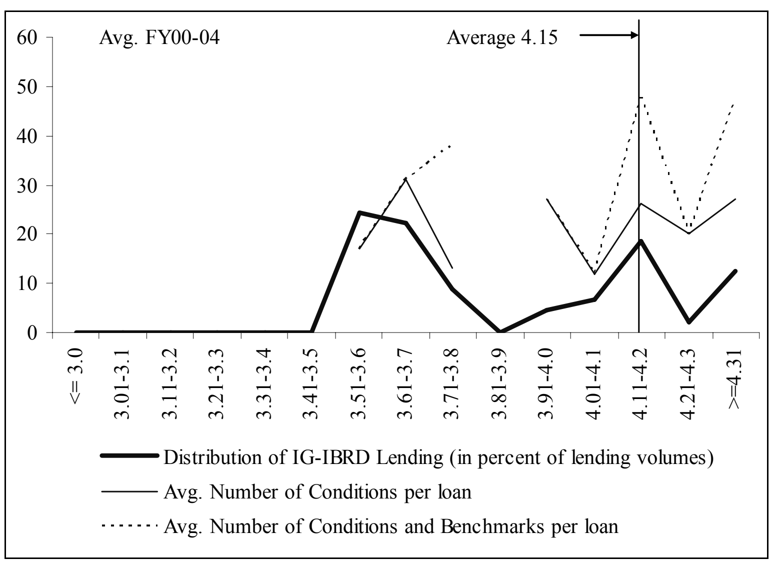
Source: ALCID, World Bank.

48. ***Public Sector Governance and Social Sector Conditions.*** Public sector governance and social sector conditions have increasingly taken the place of conditionality in financial and private sector development, trade, and economic management. Beyond these broad trends, the thematic coverage of conditions is fairly volatile given the small number of loans approved each year. For example, in FY00, 40 percent of conditions were in the governance area, and in FY04 close to 63 percent of the conditions were in the social sectors. Conditions are also moving increasingly toward rule of law and anticorruption. Public sector governance conditions are addressing corruption implementation plans and supporting greater financial disclosure of public funds, in particular transfers and subsidies.

D. Selectivity

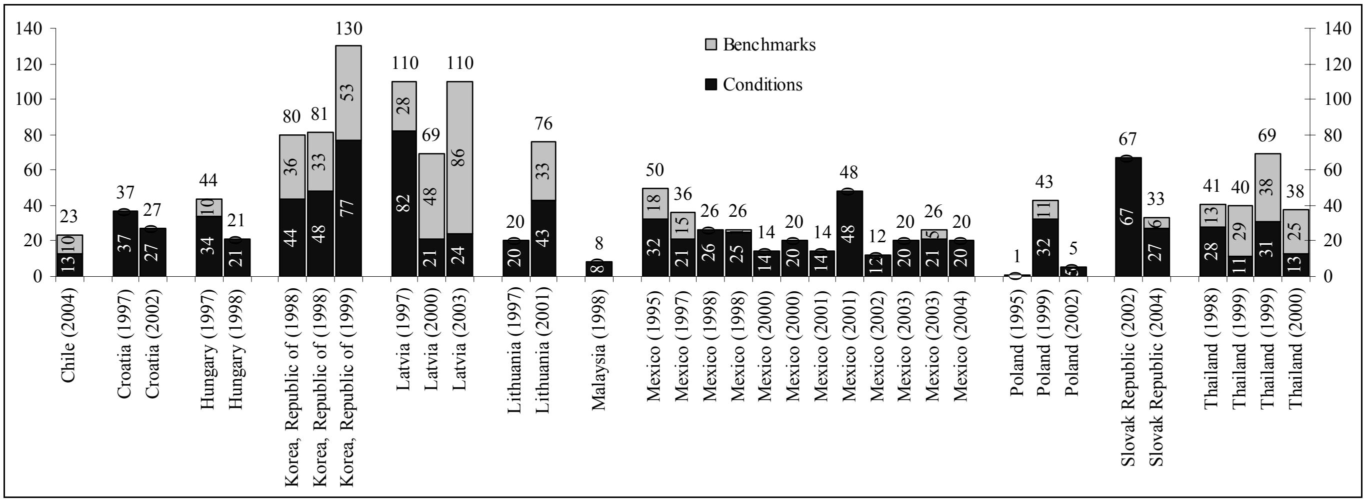
49. There is no discernible pattern of differences in this small sample as regards the number of conditions by CPIA ranking (see Figure 34). Even within countries, the number of conditions and benchmarks per loan has varied widely (see Figure 35). Similarly, there is no clear pattern as regards the use of benchmarks, possibly with the exception that they were used rather heavily in countries affected by the Asian financial crisis and in a select number of programmatic loans.

Figure 34. Share of IG-IBRD Policy-Based Lending and Conditions by Country Performance, FY00-04



Source: ALCID, CPIA (various years), World Bank.

Figure 35. Conditions and Benchmarks in Investment Grade IBRD countries, FY95-04

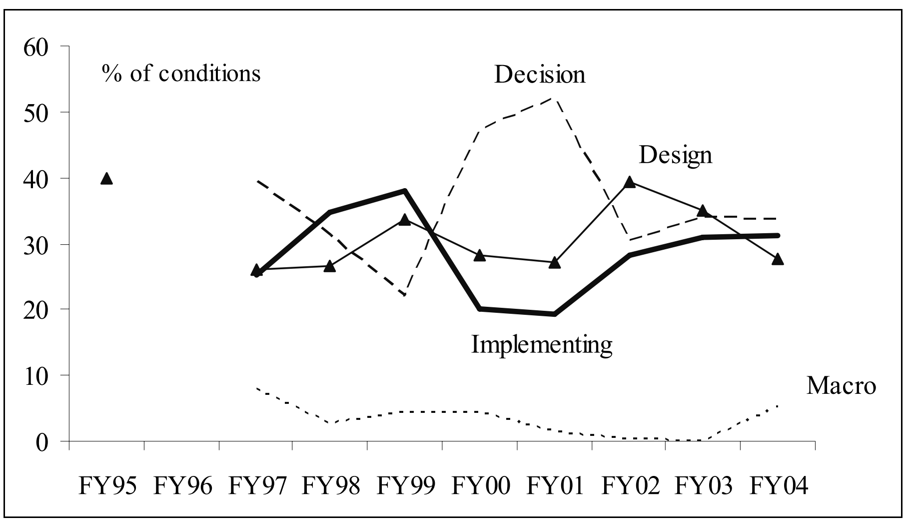


Source: ALCID, World Bank.

E. Types of Conditions

50. Similar to the sample of all countries, there is no clear trend as regards the type of conditions used other than some decline in the use of design conditions. Trends in the types of conditions reflect the content of specific country lending. Implementation and decision conditionality represent 30-40 percent of conditions each on average (see Figure 36).

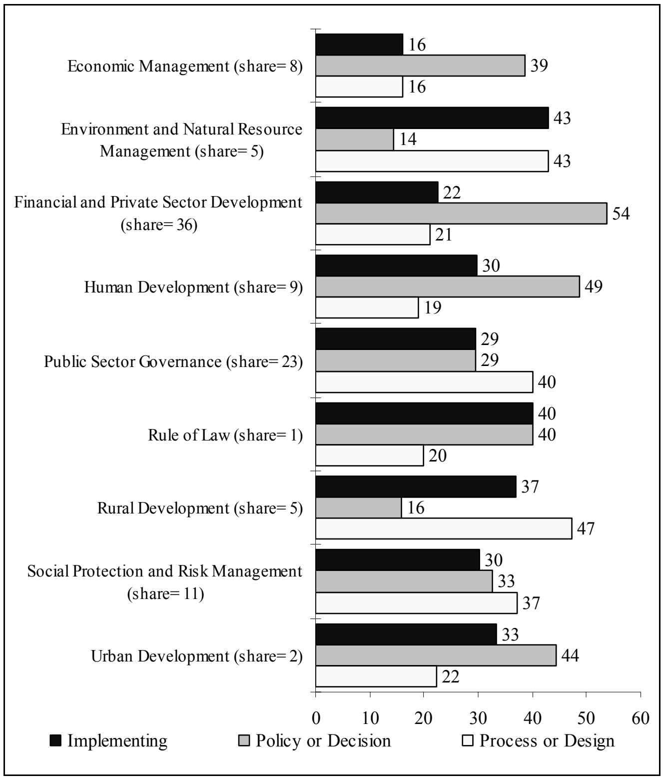
Figure 36. Trends in the Types of Conditions, FY95-05



Source: ALCID, World Bank.

51. ***Reform Area/Condition Link.*** Different reform areas typically use different types of conditions. Public sector governance and rural development conditions are mostly design conditions, while financial/private sector development, human development, economic management, and urban development conditions are mostly decision or policy conditions (see Figure 37). Environment and rural development have the highest share of implementing conditions.

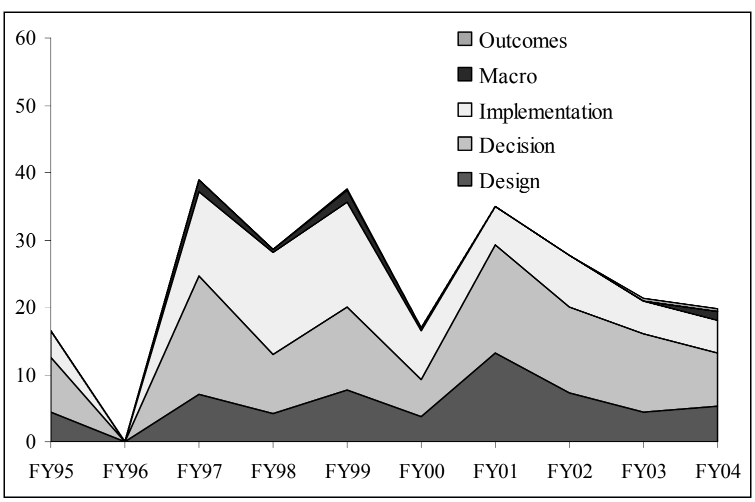
Figure 37. Types of Conditions by Themes, FY00-04



Source: ALCID, World Bank.

52. ***Type-wide Decline.*** The overall decline in conditionality has been reflected in a reduction of all types of conditions although in recent years it appears to be more focused on decision conditions (see Figure 38).

Figure 38. Trends in Avg. Number of Conditions by Themes, FY95-04



Source: ALCID, World Bank.

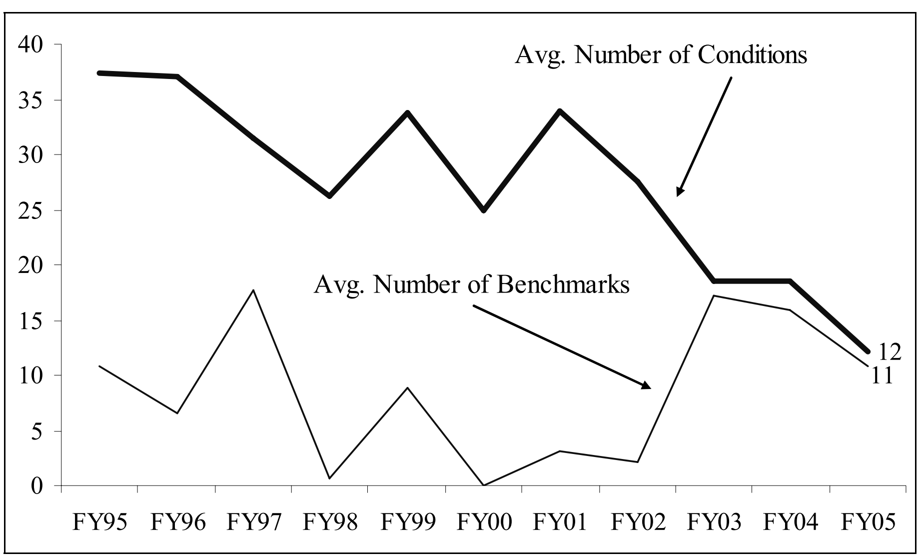
IV. CORE IBRD COUNTRIES

Overview

53. The average number of conditions for policy-based lending in core IBRD countries has declined sharply in recent years, from 37 in FY95 to 12 in FY05 (see Figure 39). The use of benchmarks in core IBRD countries is currently rather limited, and reflects the often mature relationships with borrowers, which limits the need to spell out in great detail all the program steps. Among the other major findings related to core IBRD countries are the following:

- Core IBRD countries account for the largest share of development policy lending in the Bank.
- Single-tranche loans in core IBRD countries tend to have more conditions than multitranche loans, with an increase in the gap in recent years.
- Loans tend to cover more thematic areas in recent years.
- Conditions on private sector and financial sector development have declined, driven by a reduction in conditionality on privatization, among other things.
- The share of conditions in public sector governance and rule of law has increased.
- Conditions in the social sectors also account for an increasing share.
- Economic management and trade conditions are declining; however, subnational fiscal and debt management continue to be significant.
- Loans to better performing IBRD countries have more conditions and more benchmarks than do loans to their less well performing counterparts.
- Loans to core IBRD countries typically use design type conditions less frequently than any other country group.
- A fall in design and implementing type conditions is driving the decline in conditions in recent years.

Figure 39. Trends in Number of Conditions and Benchmarks in Loans to Core IBRD Countries, FY95-05

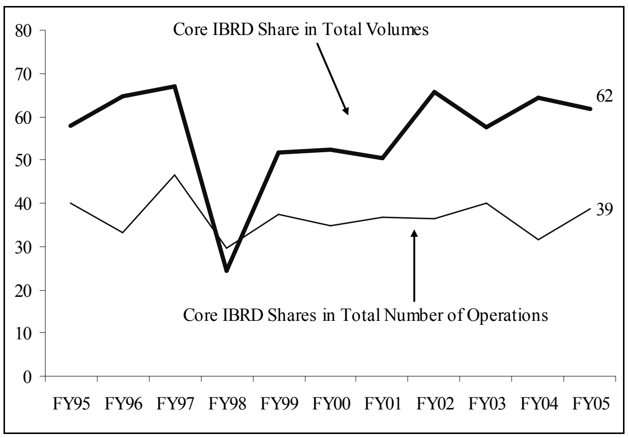


Source: ALCID, World Bank.

A. Lending Trends and Approaches

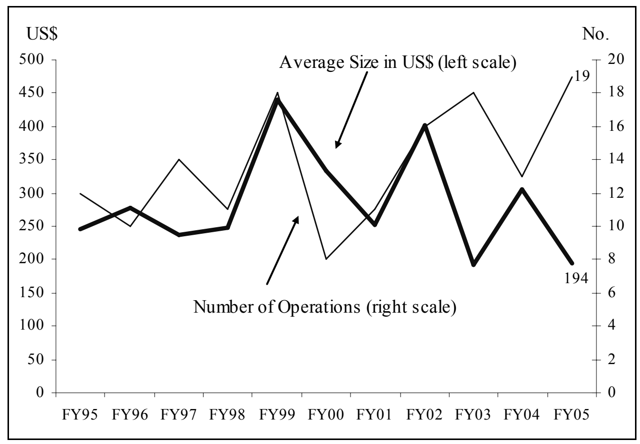
54. Core IBRD countries account for the largest share of development policy lending in the Bank, with the level fluctuating in response to crisis. On average for the past 10 years, core IBRD countries accounted for around 35 percent of policy-based loans (between 8 and 18 loans) and above half their volumes (between US$2.5 billion to US$8 billion) (see Figure 40). Lending levels are volatile and are closely correlated with crisis lending, reaching record highs of US$8 billion during FY99 and again spiking in FY02 at US$6.4 billion. The average size of loans to core IBRD countries has been declining, below the 10-year historical average loan amount (below US$200 million), mainly because of higher number of smaller operations approved in recent years (see Figure 41).

Figure 40. Trends in the Share of Core IBRD in Total Policy-Based Lending and in Total Number of Policy-Based Operations, FY95-05



Source: SAP Business Warehouse, World Bank.

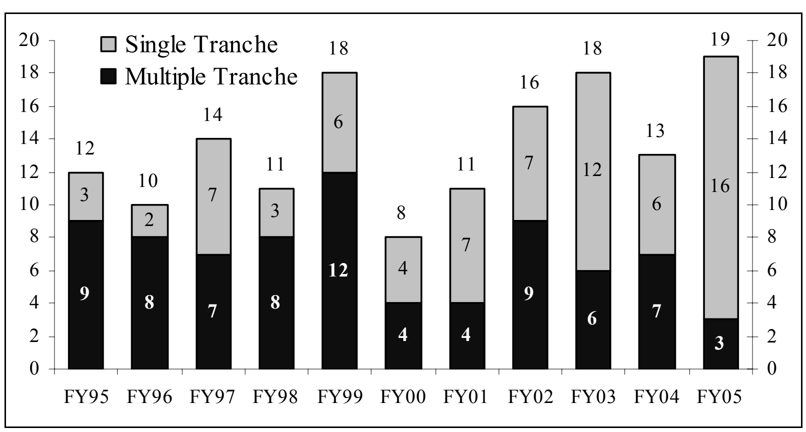
Figure 41. Trends in Size of Core IBRD Loans in US$ and Number of Operations, FY95-05



Source: SAP Business Warehouse, World Bank.

55. ***Single-Tranche Loans.*** Policy-based loans are increasingly programmatic series of single-tranche loans. Sixteen of the nineteen loans approved in FY05 were single-tranche loans. A decade ago, 75 percent of loans were multitranche (see Figure 42). This transition partly reflects the increased flexibility provided by single-tranche programmatic loans in implementing complex medium-term programs. The number of multitranche loans is higher during crisis years, indicating that they may be the preferred instrument in crisis situations—the share of multitranche loans in total loans peaked during in FY98-98 and again in FY02 (crisis years). Another important finding is that the lending instrument is also country-

Figure 42. Trends in the Number of Single-Tranche and Multiple Tranche Loans, FY95-05



Source: SAP Business Warehouse, World Bank.

specific. In some countries, all of the Bank's loans over the past 10 years have had multiple tranches, or the most loans did, as in the case of Argentina (17 out of 18 loans), Russia (8 out of 9 loans), or Turkey (5 out of 7 loans). By contrast, all of the recent 12 loans to Brazil have been single-tranche. Presumably, the loan design reflects the Bank's strategic choice in response to the country's policy environment and track record.

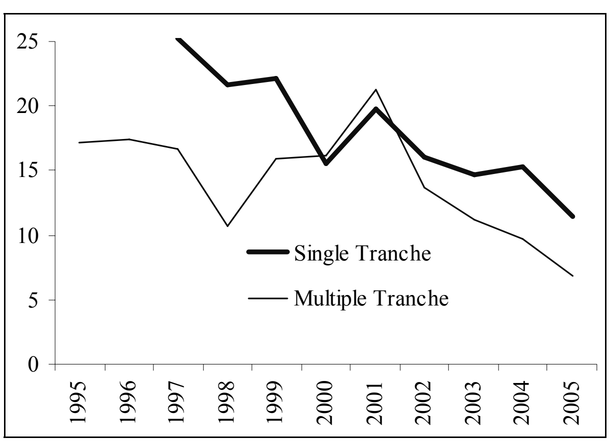
56. ***Programmatic Loans.*** Programmatic approaches are increasingly used in IBRD loans. In FY05, around 40 percent of the loans to core IBRD countries and over 60 percent of loan volumes followed programmatic approaches, compared with less than 20 percent in both counts in FY02. This growth is also reflected in the growth in single-tranche loans, as most programmatic loans have a single tranche.

B. Number of Conditions

57. Conditions have declined by two-thirds over the past 10 years in core IBRD countries, from 37 conditions on average in FY95 to 12 conditions on average in FY05. The number of benchmarks used has fluctuated between 0 and 15 on average, but without any clear trend in aggregate (see Figure 39). There are some outliers, however, where the number of benchmarks has been large over a sustained period of time (e.g., Bulgaria: PAL1 (2003) with 59 benchmarks, PAL2 (2004) with 83 benchmarks, and PAL3 (2005) with 94 benchmarks). Yet, use of benchmarks is markedly less important in IBRD loans compared to IDA loans: core IBRD loans had 11 benchmarks on average in FY05 (6 benchmarks if excluding Bulgaria PAL3), compared with more than 40 benchmarks on average in IDA loans over the same period.

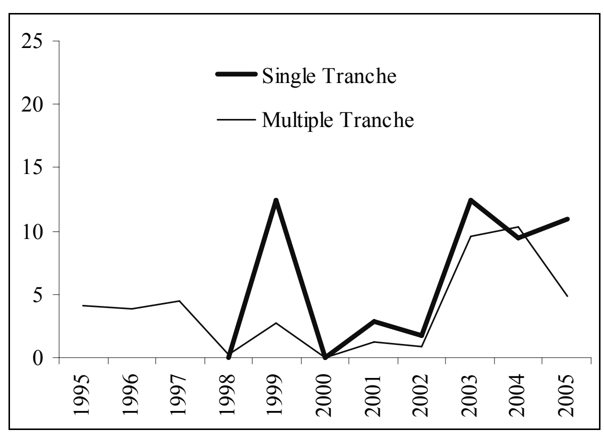
58. ***Single-Tranche/Multitranche Comparison.*** After correcting for the number of conditions per tranche, over the past 10 years, multitranche loans have had on average fewer conditions than single-tranche loans (see Figure 43). This gap appears to have widened somewhat in recent years. However, there is no marked difference in use of benchmarks, but multitranche loans had fewer benchmarks in FY05 than single-tranche loans (see Figure 44).

Figure 43. Trends in Conditions in Single- and Multitranche Loans, FY95-05
(corrected for the number of conditions per tranche)



Source: ALCID, World Bank.

Figure 44. Trend in Benchmarks in Single- and Multitranche Loans, FY95-05
(corrected for the number of conditions per tranche)



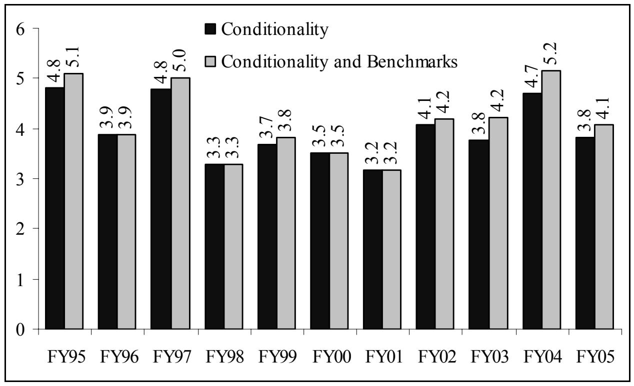
Source: ALCID, World Bank.

C. Thematic Coverage

59. After a decline between FY95 and FY98, thematic coverage of loans in core IBRD countries has tended to increase in recent years. This trend reflects the shift from more narrowly

focused crisis-related operations to more comprehensive policy-based support under multitranche or programmatic operations (see Figure 45). Thematic coverage in programmatic loans increased in FY04 to five thematic areas from three in the previous year, and fell in FY05.

Figure 45. Trends in the Avg. Number of Themes in Conditions and Benchmarks, FY95-05



Source: ALCID, World Bank.

60. ***Financial Sector and PSD Conditionality.*** The decline of privatization-related conditions is driving the fall in financial sector and PSD-related conditions. Notwithstanding this trend, the Bank still puts emphasis on regulatory and competition policies and is increasingly supporting approaches to improve infrastructure services in selected IBRD countries. Ten years ago, in FY95, around 30 percent of conditions in core IBRD countries were in support of state restructuring and privatization, and in developing the legal framework for privatization (see Table 3). In FY04, this share was less than 5 percent and most was focused on the governance framework rather than on actual transactions. Regulatory and competition policy conditions, however, have maintained a relatively constant but important share in conditions, between 7-16 percent, indicating the continued need for deregulation, administrative simplification, and the regulatory framework for financial and private sector development.

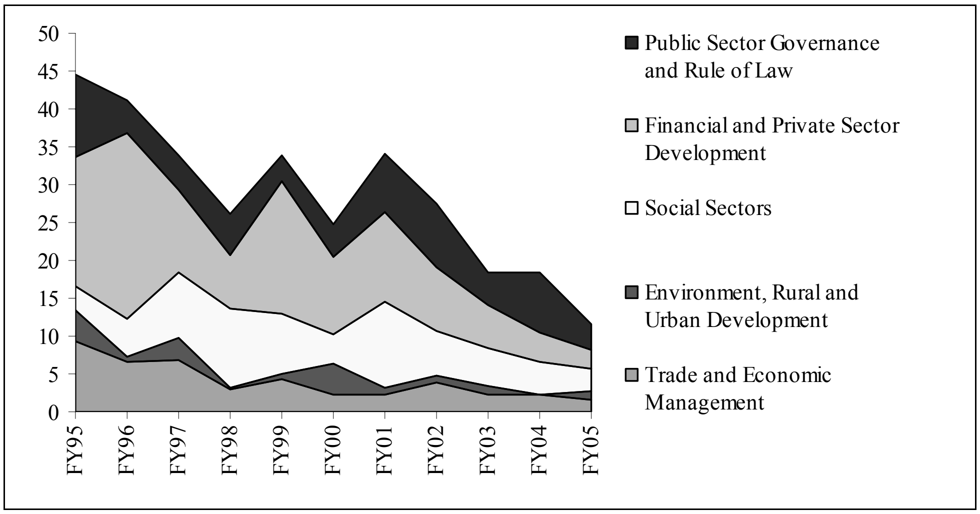
Table 3. Trends in the Share of Conditions in Core IBRD Loans by Themes, FY95-04

	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04	Avg. FY00-04
Number of Loans	**10**	**9**	**13**	**11**	**18**	**8**	**11**	**16**	**18**	**13**	**13**
Conditions - Number of Conditions	**446**	**370**	**439**	**288**	**608**	**199**	**374**	**441**	**332**	**240**	**317**
in shares of Conditions (%)											
Trade and Economic Management	21.1	15.9	20.0	11.1	12.5	9.5	6.4	13.8	12.3	12.1	10.8
Environment, Rural and Urban Development	9.2	1.6	9.1	0.7	2.1	16.1	3.2	3.6	5.7	0.8	5.9
Social Sectors	7.2	12.2	25.5	39.9	23.8	15.1	33.2	21.5	28.0	23.3	24.2
Human Development	0.0	9.2	2.3	23.3	5.4	1.5	28.3	14.1	15.7	12.9	14.5
Social Development, Gender and Inclusion	0.4	0.0	0.0	0.0	0.5	0.0	0.5	0.9	0.3	2.9	0.9
Social Protection and Risk Management	6.7	3.0	23.2	16.7	17.9	13.6	4.3	6.6	12.0	7.5	8.8
Financial and Private Sector Development	38.1	59.7	31.9	27.1	52.0	41.7	34.5	30.2	30.1	20.0	31.3
Corporate governance	0.0	0.0	0.0	0.3	0.7	0.0	0.3	0.9	0.3	0.8	0.5
Infrastructure services for private sector development	0.0	0.0	2.1	0.3	0.0	0.0	1.6	0.7	1.2	2.5	1.2
Other financial & private sector development	0.9	7.6	2.3	0.7	4.6	1.0	1.1	3.9	2.4	1.7	2.0
Regulation and competition policy	6.5	15.7	8.0	7.3	19.4	13.6	7.8	9.3	16.0	6.7	10.6
Small and medium enterprise support	0.0	0.3	0.0	0.0	0.3	0.0	0.0	0.7	0.0	2.1	0.6
Standards and financial reporting	1.6	7.0	0.7	1.0	5.3	4.5	5.9	2.9	0.0	1.7	3.0
State enterprise/bank restructuring and privatization	29.1	29.2	18.9	17.4	21.7	22.6	17.9	11.8	10.2	4.6	13.4
Public Sector Governance and Rule of Law	24.4	10.5	13.4	21.2	9.5	17.6	22.7	30.8	23.8	43.8	27.7
Public expenditure, financial management and procureme	3.6	1.4	2.7	8.0	1.3	5.0	5.6	12.5	6.0	22.5	10.3
Administrative and civil service reform	3.8	0.3	1.4	6.6	0.8	5.0	6.7	4.3	5.4	7.9	5.9
Tax policy and administration	5.8	2.2	6.2	1.4	4.1	6.5	4.3	7.5	2.7	4.6	5.1
Decentralization	0.0	0.0	0.0	0.0	0.2	0.0	1.1	0.0	0.6	0.4	0.4
Rule of Law	0.2	0.5	0.2	0.0	1.8	0.0	1.9	0.9	3.9	5.8	2.5
Other public sector governance, accountability/anti-corru	11.0	6.2	3.0	5.2	1.3	1.0	3.2	5.7	5.1	2.5	3.5
Other accountability/anti-corruption	0.0	0.0	0.0	0.0	0.0	0.0	0.5	1.4	0.6	0.4	0.6
Other public sector governance	11.0	6.2	3.0	5.2	1.3	1.0	2.7	4.3	4.5	2.1	2.9

Source: ALCID, World Bank.

61. ***Public Sector Governance.*** Public sector governance is increasing its share of conditions (see Figure 46 and Table 3), reflecting an increased focus on public expenditure, financial management, and procurement issues. In the last decade, public sector governance conditions increased from around 15 percent to around 30 percent, on average. The aim of public sector governance conditions is to improve aggregate fiscal control and the quality of public spending through more comprehensive budgets, improvement of poverty targeting, the development of transparent budget allocation processes, and public procurement, public financial control, and accounting systems. Administrative and civil service reforms also play a role, but to a lesser extent than in IDA countries.

Figure 46. Trends in the Composition of Average Conditions Per Loan, by Themes, FY95-05



Source: ALCID, World Bank.

62. ***Rule of Law.*** Conditionality addressing rule of law issues is increasing in core IBRD countries, from a low base of about 1 percent of conditions in FY01-02, to close to 6 percent of conditions in FY04. In Colombia, for instance, the Bank supported the establishment of a new policy for the legal defense of the state; in Peru, the Bank was instrumental in the design of a law of transparency and access to public information and its regulation; in Jordan, Bank conditions supported the adoption of a systematic training program for judges and auxiliaries of justices.

63. ***Social Sectors.*** Conditions in the social sectors have increased from around 10 percent a decade ago to about 25 percent recently. Bank conditions in this area are increasingly focusing on programs aimed at improving child health and education status, including MDG-related goals, such as reducing child mortality and morbidity through policies and strategies focusing on improving the quality of education or health services. In Colombia, for instance, the Bank supported an increase of basic and secondary net enrollments, by at least 300,000 new students in a set period of time and in the student-to-teacher ratio by one student per teacher, also in a specific time period. The emphasis on social protection and risk management issues has declined, from 20 percent of social sector conditions during the late 1990s to around 7-8 percent in recent years. Social protection conditions tend to be more important during crisis periods.

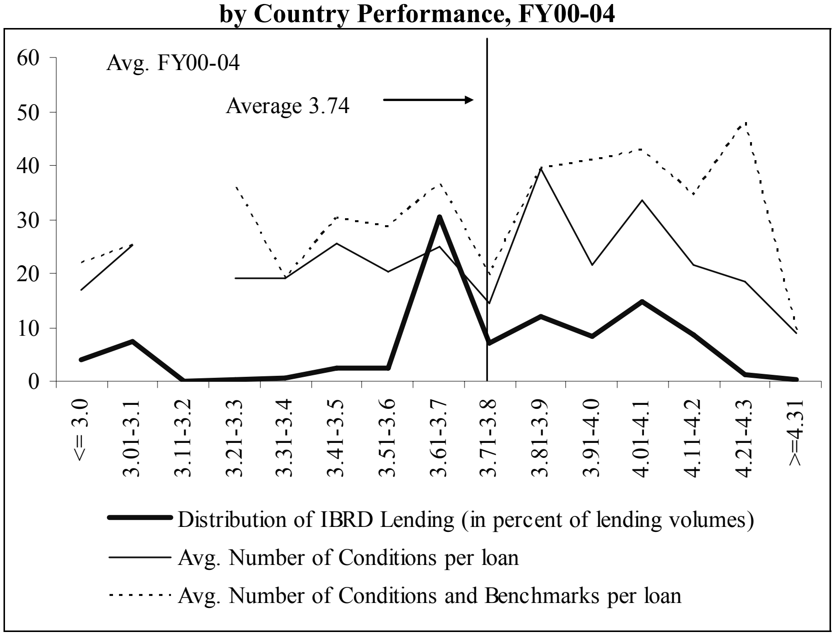
64. ***Economic Management and Trade.*** While economic management and trade conditions have declined, issues of subnational fiscal and debt management continue to account for an

important share of economic management conditions. In addition to operational policy requirement[7] of having an adequate macroeconomic policy framework whenever a development policy operation is disbursed, about half of the loans approved in FY00-04 had specific economic management conditionality related to achieving or maintaining a satisfactory macroeconomic program or addressing debt management and fiscal sustainability issues (including subnational borrowing and spending rules and limitations, as was the case for the Argentina, Brazil, and Russia).

D. Selectivity

65. Loans to above average performing IBRD countries (CPIA ratings above 3.8) tend to include more conditions and more benchmarks than loans to their less well performing counterparts. Around 40 percent of the loans to core IBRD countries during FY00-04 went to above average performing countries (see Figure 47) with 27 conditions on average, compared with 22 conditions on average in below average performers. IBRD loans with the lowest number of average conditions per loan usually have highest number of benchmarks. For example, none of the loans to Argentina in FY98-99, which averaged 20-30 conditions per loan tranche, had benchmarks. The use of benchmarks is therefore not subject to any particular trend but reflects country circumstances—Bulgaria's programmatic loans made heavy use of benchmarks, whereas Colombia's development policy loans used none.

Figure 47. Share of Core IBRD Policy-Based Lending and Conditions by Country Performance, FY00-04



Source: ALCID, CPIA (various years), World Bank.

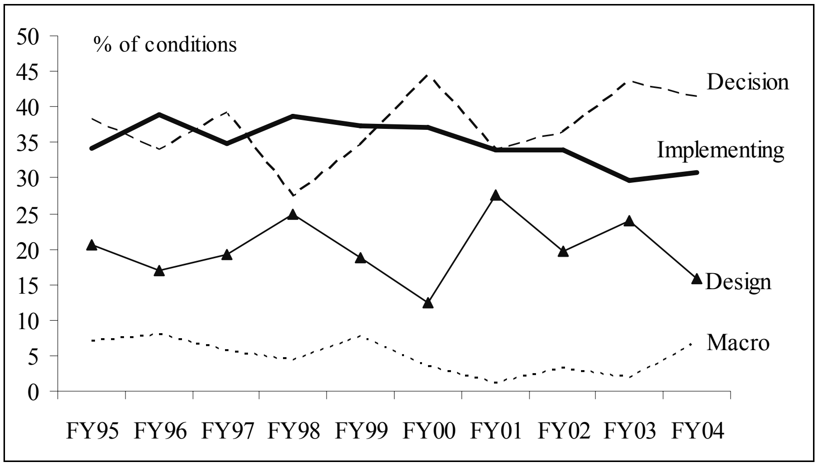
E. Types of Conditions

66. Loans to core IBRD countries typically have the lowest concentration of design type conditions compared with other country groups. On average, about 20 percent of loan conditions in this group are design type conditions, 35 percent are implementing types conditions (but on a

7 See OP 8.60*, Development Policy Lending*, paragraphs 5 and 13.

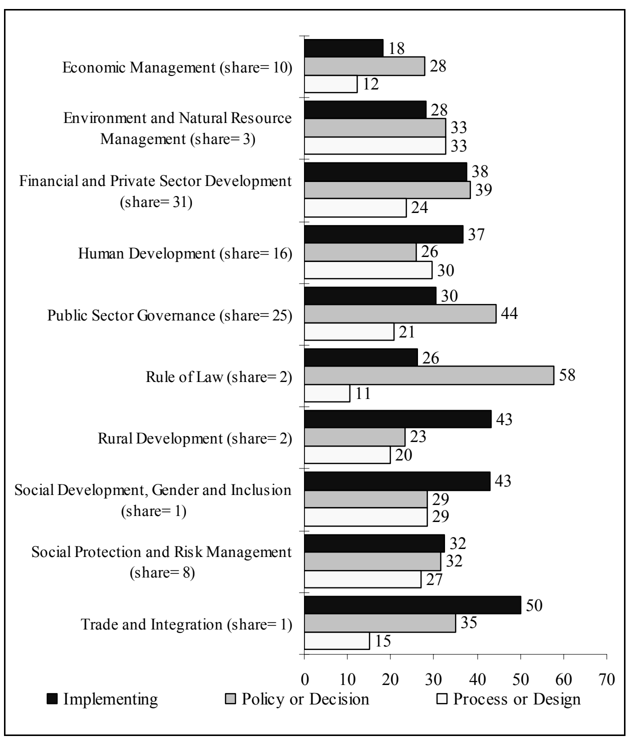
slow decreasing path), and above 40 percent are decision type or policy type conditions, which appear to be growing in importance (see Figure 48).

Figure 48. Trends in the Types of Conditions, FY95-04



67. ***Thematic Areas.*** The types of conditions vary by thematic area. Conditions in the public sector governance contain the highest concentration of decision conditions, reflecting the greater attention to a step-by-step approach to institutional reforms (see Figure 49). In contrast to other country groups, IBRD countries use very little design conditionality. Conditions in the rural sectors and the social sectors show high use of implementing conditions.

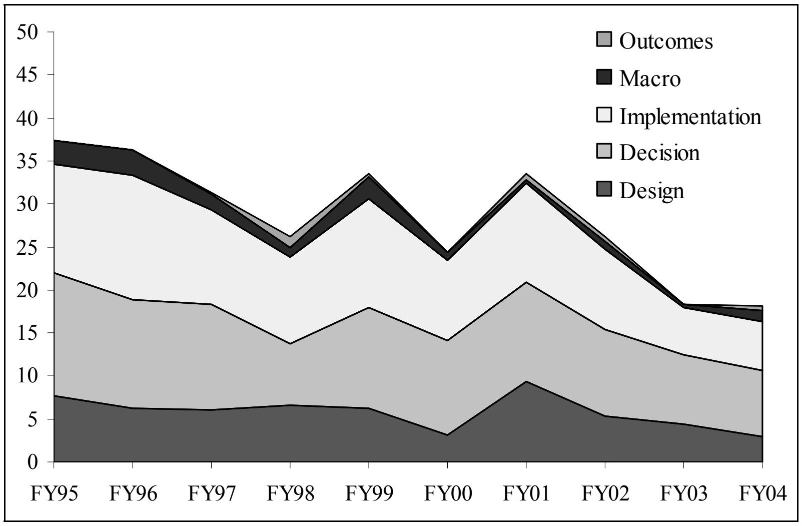
Figure 49. Trends in the Types of Conditions by Themes, FY00-04 (Avg., in %)



Source: ALCID, World Bank.

68. ***Types of Conditions.*** The rapid fall in average loan conditions to core IBRD countries in recent years (FY02-04) is attributable to the decline of design conditions (from 9 out of 34 conditions in FY01 to 3 out of 19 conditions in FY04) and implementation conditions (from 12 out 34 conditions in FY01 to 6 out of 19 conditions in FY04). Decision conditions declined little and increased their share in conditions (see Figure 50).

Figure 50. Trends in the Avg. Number of Conditions by Themes, FY95-04



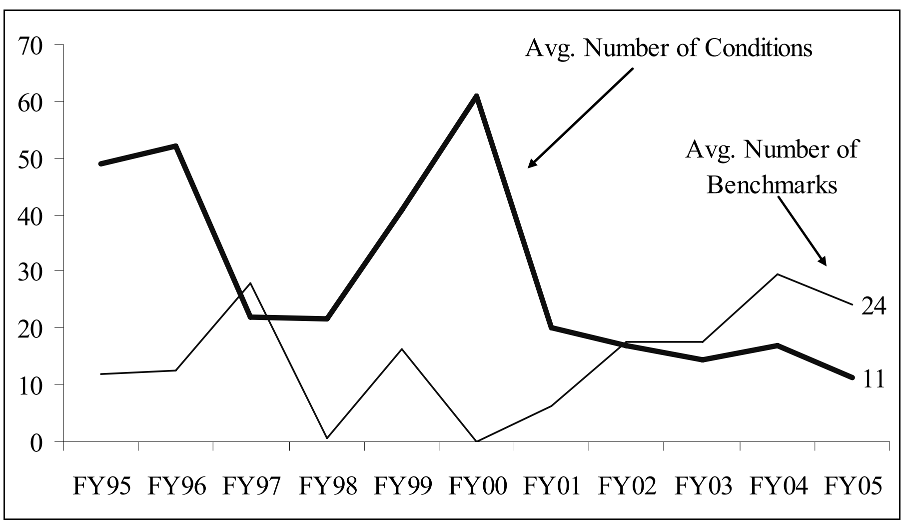
V. BLEND COUNTRIES

Overview

69. Conditions in policy-based loans to blend countries have been declining at the same rate as in other country groupings (see Figure 51). The average blend country loan has about as many conditions as comparable IDA loans. Among other findings are the following:

- Single-tranche loans are becoming the preferred instrument in blend countries and have seen the largest decline in the number of conditions.
- Programmatic approaches have been used less frequently in blend countries than in other country groups.
- As in IDA countries, the use of benchmarks has increased in recent years.
- Thematic coverage of loans declined from the mid-1990s, but the trend appears to have reversed in recent years.
- Conditions in public sector governance are important as in IDA countries.
- On average, better performers receive larger policy-based lending volumes with slightly fewer conditions.
- Most conditions are of the decision type.

Figure 51. Trends in Conditions and Benchmarks in Loans to Blend Countries, FY95-05

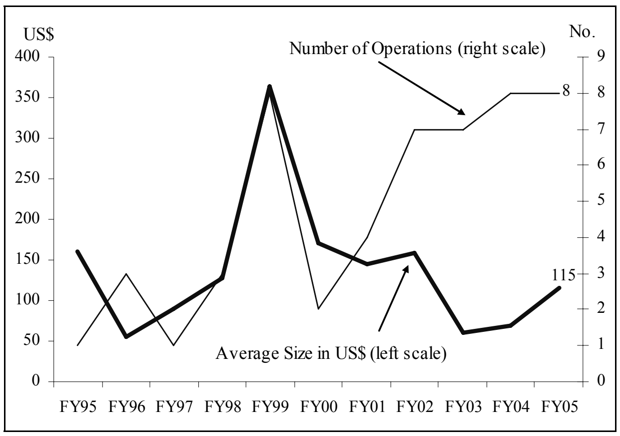


Source: ALCID, World Bank.

A. Lending Trends and Approaches

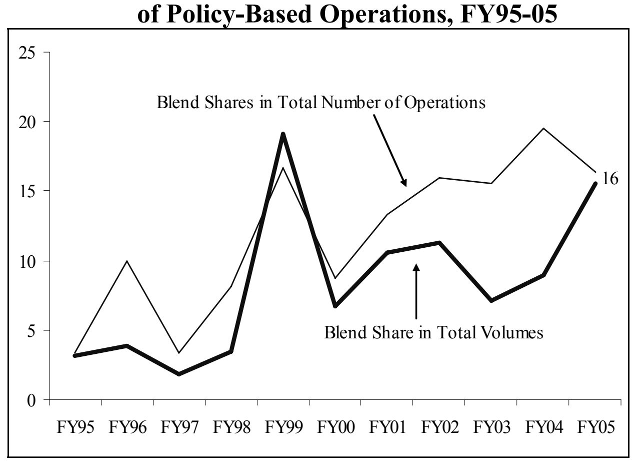
70. Loans to blend countries have been increasing in recent years. Excluding the three large loans to Indonesia during the East Asia crisis (US$2.4 billion), on average the Bank annually approved one to three loans to blend countries during the second half of the 1990s, compared to seven to eight loans during FY04-05 (see Figure 52). A similar growth is seen in terms of volumes, growing from around US$160 million in FY95-96 to US$600-900 million in FY04-05. However, these volumes account for a small share of total Bank policy-based lending over the past 10 years (around 10 percent), although they have been growing sharply in recent years (see Figure 53). Average loan size peaked in FY99 at US$360 million, and has been declining since, to around US$70 million in FY03-04 (however, FY05 saw a reversal of this declining trend).

Figure 52. Trends in Size of Blend Loans in US$ and Number of Operations, FY95-05



Source: SAP Business Warehouse, World Bank.

Figure 53. Trends in the Share of Blend Loans in Total Policy-Based Lending and in Total Number of Policy-Based Operations, FY95-05

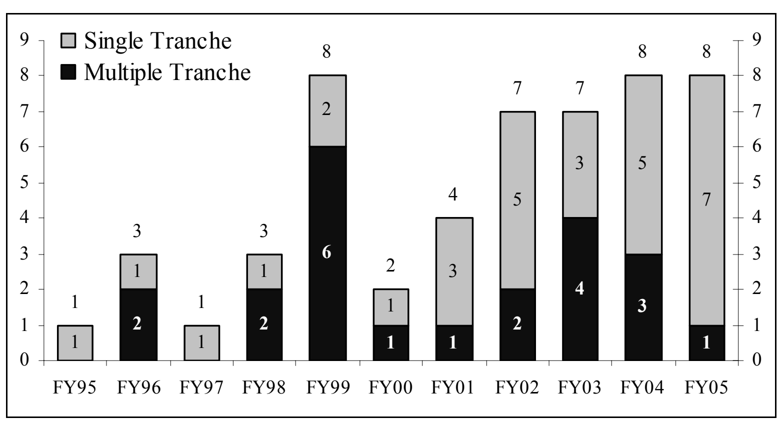


Source: SAP Business Warehouse, World Bank.

71. ***Single-Tranche Loans.*** As with the rest of the country groups, single-tranche loans are becoming the preferred design in blend countries. Only one of the loans approved in FY05 was multitranche, compared with six out of eight loans in FY99 during the East Asia crisis. There are also some indications that design selection reflects instrument flexibility, country circumstances, such as track record and country-specific risk, and possibly country preferences (see Figure 54).

72. ***Programmatic Approaches.*** Programmatic approaches have not yet been used widely in blend countries. Since the introduction of programmatic approaches in FY00, only 6 of the 29 loans to blend countries have been programmatic, even when loans were increasingly single-tranche. Programmatic approaches were most widely used in Bolivia (FY01, FY03, FY04), for subnational lending in India (two loans in FY02), and very recently in Pakistan (FY05).

Figure 54. Trends in the Number of Single Tranche and Multitranche Loans, FY95-05



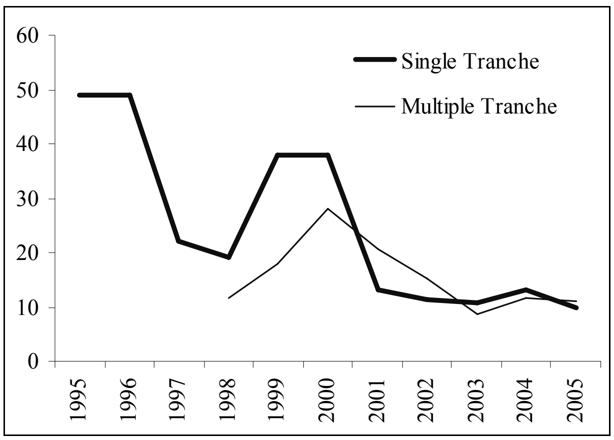
Source: SAP Business Warehouse, World Bank.

B. Number of Conditions

73. Compared to other country groups, loans to blend countries carry the smallest number of conditions, averaging about 10 per tranche. Average conditions in single-tranche loans in blend countries declined from around 50 in FY95 to 10 or fewer a decade later—by far the largest decline in conditions. An upturn in the number of conditions can be observed in FY99-00 during the Asian financial crisis, when lending to Indonesia carried almost 60 conditions in a single-tranche operation. Since FY01, the number of conditions in both single- and multitranche operations, has been low (see Figure 55).

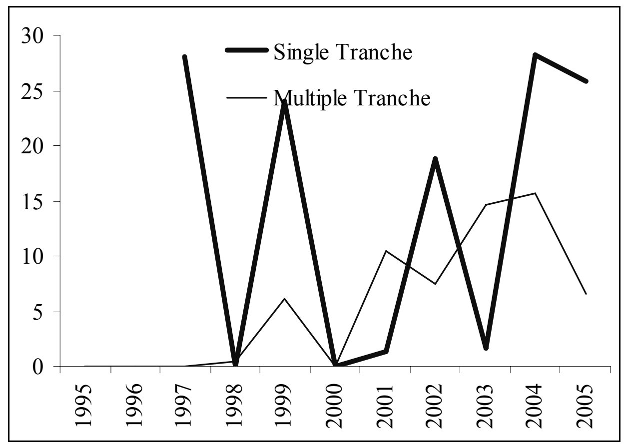
74. ***Benchmarks.*** The use of benchmarks has been growing in the past two years. As with IBRD countries, use of benchmarks is driven by country-specific situations (see Figure 56). For instance, the recent increases reflect loans to Pakistan, including a recent PRSC. These loans contain a fairly large number of indicative actions to describe the country's program.

Figure 55. Trends in Conditions in Single- and Multitranche Loans, FY95-05
(corrected for the number of conditions per tranche)



Source: ALCID, World Bank.

Figure 56. Trends in Benchmarks in Single- and Multitranche Loans, FY95-05
(corrected for the number of conditions per tranche)

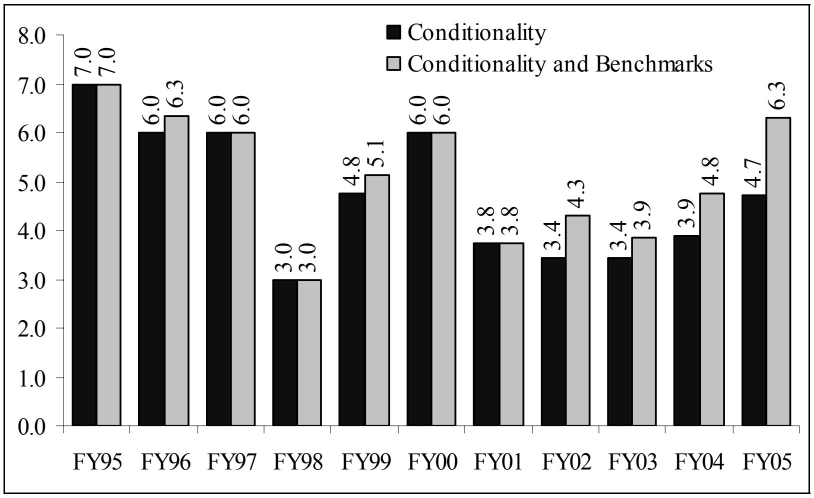


Source: ALCID, World Bank.

C. Thematic Coverage

75. Thematic coverage of loans has declined since the mid-1990s, but the trend seems to have reversed recently when the coverage of conditions increased from an average of three to four to closer to five (see Figure 57). Some coverage has also been added through the use of benchmarks.

Figure 57. Trends in Avg. Themes in Conditions and Benchmarks, FY95-05



Source: ALCID, World Bank.

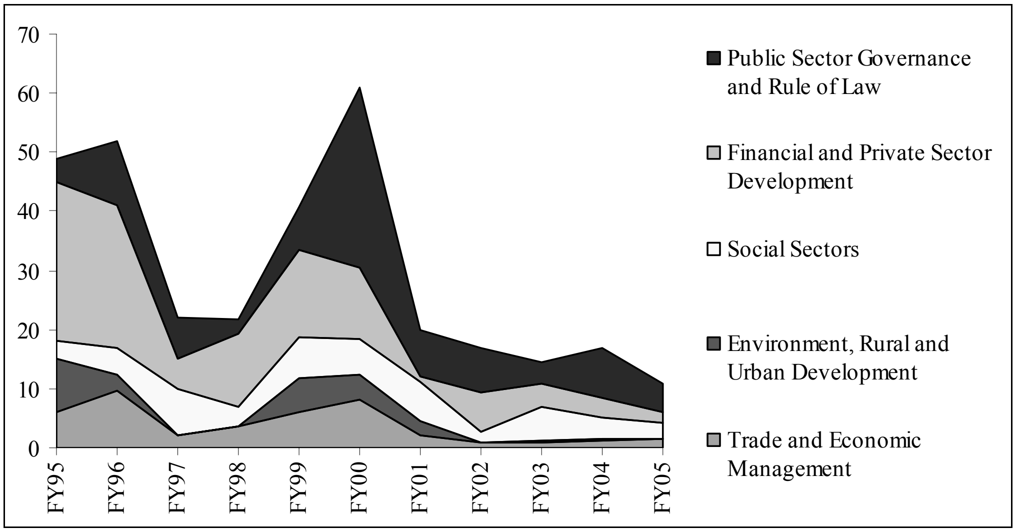
76. ***Thematic Trends.*** On average, public sector governance conditions account for about half of the conditions in blend countries. This represents a strong increase since the second half of the 1990s, when these conditions accounted for about 20 percent of conditions (see Table 4). Rule of law conditions and anticorruption conditions have also been growing, particularly in the South Asia Region. As in other country groups, macro/trade and financial sector and private sector development conditions have declined both in absolute terms (falling from more than 15 in FY99 to 1-2 in FY05) and as a share of conditions (see Figure 58).

Table 4. Trends in the Share of Conditions in Blend Loans by Themes, FY95-04

	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04	Avg. FY00-04
Number of Loans	**1**	**3**	**1**	**3**	**8**	**2**	**4**	**7**	**7**	**8**	**6**
Conditions - Number of Conditions	**49**	**156**	**22**	**65**	**327**	**122**	**80**	**118**	**102**	**135**	**111**
in shares of Conditions (%)											
Trade and Economic Management	12.2	18.6	9.1	16.9	14.7	13.1	11.3	5.9	5.9	7.4	8.7
Environment, Rural and Urban Development	18.4	5.1	0.0	0.0	13.8	7.4	11.3	0.0	2.0	1.5	4.4
Social Sectors	6.1	9.0	36.4	15.4	17.1	9.8	33.8	9.3	40.2	20.7	22.8
Human Development	2.0	3.2	13.6	0.0	4.0	7.4	5.0	3.4	16.7	11.1	8.7
Social Development, Gender and Inclusion	0.0	0.0	9.1	0.0	2.4	0.0	10.0	0.0	1.0	3.0	2.8
Social Protection and Risk Management	4.1	5.8	13.6	15.4	10.7	2.5	18.8	5.9	22.5	6.7	11.3
Financial and Private Sector Development	55.1	46.2	22.7	56.9	36.7	19.7	3.8	39.8	27.5	20.7	22.3
Corporate governance	0.0	0.0	0.0	0.0	1.2	0.8	0.0	0.0	0.0	0.0	0.2
Infrastructure services for private sector development	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other financial & private sector development	4.1	0.6	9.1	1.5	0.6	0.8	0.0	7.6	1.0	0.7	2.0
Regulation and competition policy	10.2	23.1	9.1	15.4	11.3	4.9	1.3	22.0	11.8	5.9	9.2
Small and medium enterprise support	0.0	0.6	0.0	0.0	0.0	0.8	0.0	0.8	0.0	0.0	0.3
Standards and financial reporting	6.1	0.0	0.0	7.7	2.1	1.6	0.0	0.0	2.0	0.0	0.7
State enterprise/bank restructuring and privatization	34.7	21.8	4.5	32.3	21.4	10.7	2.5	9.3	12.7	14.1	9.9
Public Sector Governance and Rule of Law	8.2	21.2	31.8	10.8	17.7	50.0	40.0	44.9	24.5	49.6	41.8
Public expenditure, financial management and procureme	0.0	4.5	13.6	7.7	7.6	16.4	20.0	23.7	9.8	28.9	19.8
Administrative and civil service reform	0.0	4.5	0.0	0.0	0.9	15.6	5.0	4.2	2.9	5.9	6.7
Tax policy and administration	4.1	5.8	18.2	3.1	6.4	9.0	3.8	2.5	2.9	2.2	4.1
Decentralization	0.0	0.6	0.0	0.0	0.9	1.6	2.5	0.0	2.0	1.5	1.5
Rule of Law	0.0	0.0	0.0	0.0	0.3	0.0	0.0	1.7	2.0	4.4	1.6
Other public sector governance, accountability/anti-corru	4.1	5.8	0.0	0.0	1.5	7.4	8.8	12.7	4.9	6.7	8.1
Other accountability/anti-corruption	0.0	0.0	0.0	0.0	0.3	5.7	1.3	2.5	1.0	1.5	2.4
Other public sector governance	4.1	5.8	0.0	0.0	1.2	1.6	7.5	10.2	3.9	5.2	5.7

Source: ALCID, World Bank.

Figure 58. Trends in the Composition of Conditions by Themes, FY95-05

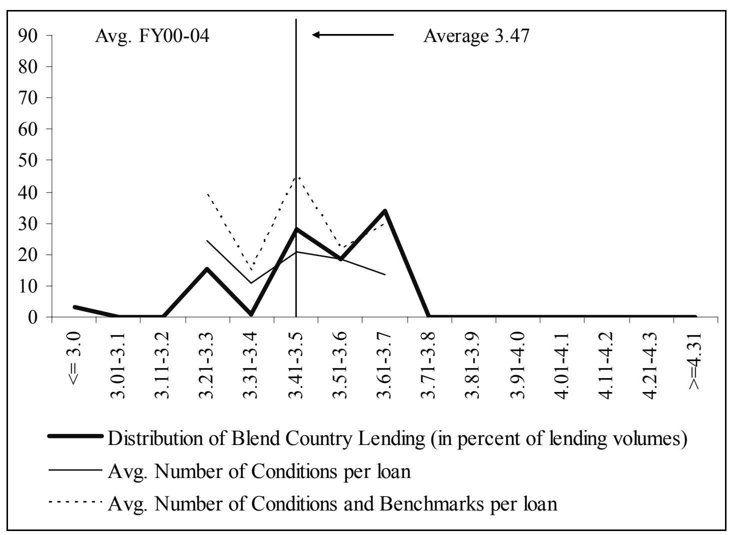


Source: ALCID, World Bank.

D. Selectivity

77. Better performers receive higher lending volumes with slightly fewer conditions in FY00-04 than their less well performing counterparts (see Figure 59). The average number of conditions appears to be declining slightly with rising performance, but the pattern is not strong.

Figure 59. Share of Blend Country Policy-Based Lending and Conditions by Country Performance, FY00-04

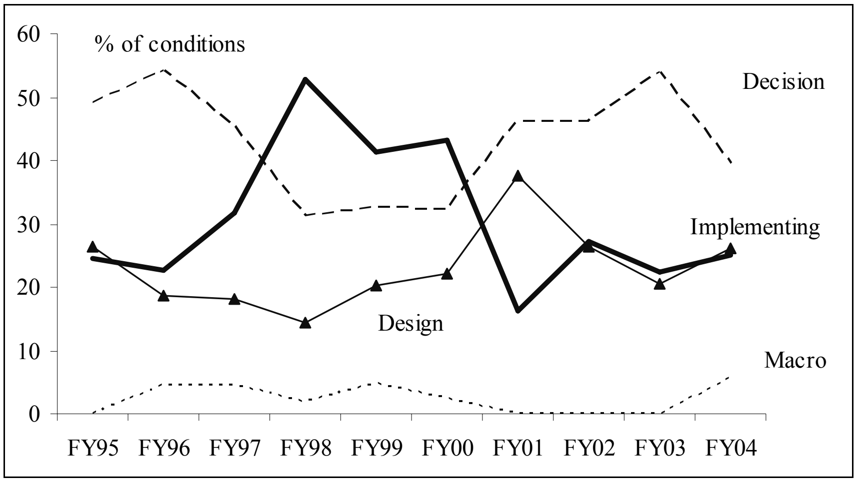


Source: ALCID, CPIA (various years), World Bank.

E. Types of Conditions

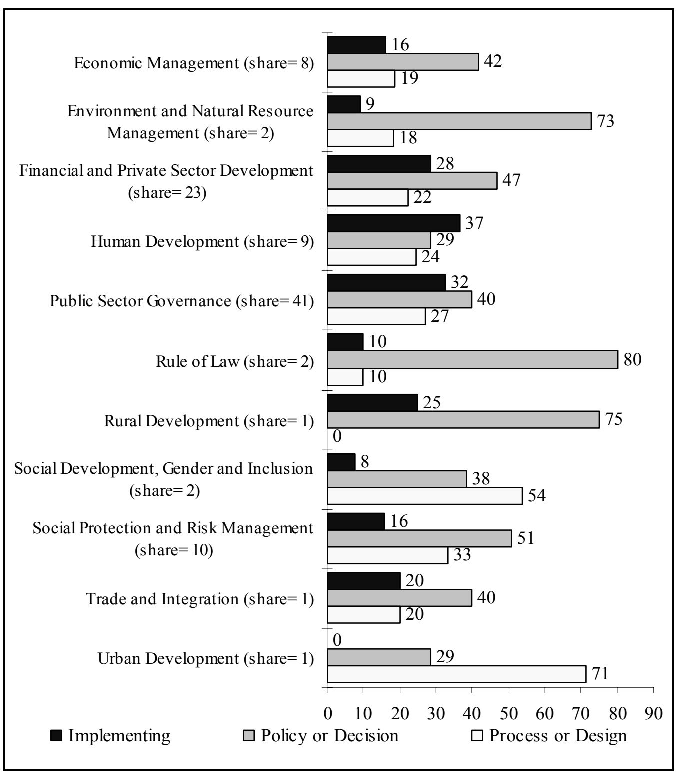
78. The mix of condition types in policy-based loans in blend countries has changed over the past decade. During the second half of the 1990s, there was a large increase in implementation conditions, largely driven by the package of four crisis loans to Indonesia and the series of policy reform loans to Bosnia-Herzegovina. In FY00-04, decision type conditions have predominated, accounting for around 44 percent of all conditions (see Figure 60). Loans to Bolivia and Bosnia-Herzegovina have contributed to this increase. Process or design type conditions have fluctuated around 20 percent on average.

Figure 60. Trend in the Types of Conditions, FY95-05



79. ***Condition Type by Theme.*** On average, decision conditions accounted for the largest group of conditions in most of the thematic areas in loans to blend countries, except in social development and urban development, where process or design type conditions are more popular (see Figure 61).

Figure 61. Trends in the Types of Conditions by Themes, FY00-04



Source: ALCID, World Bank.

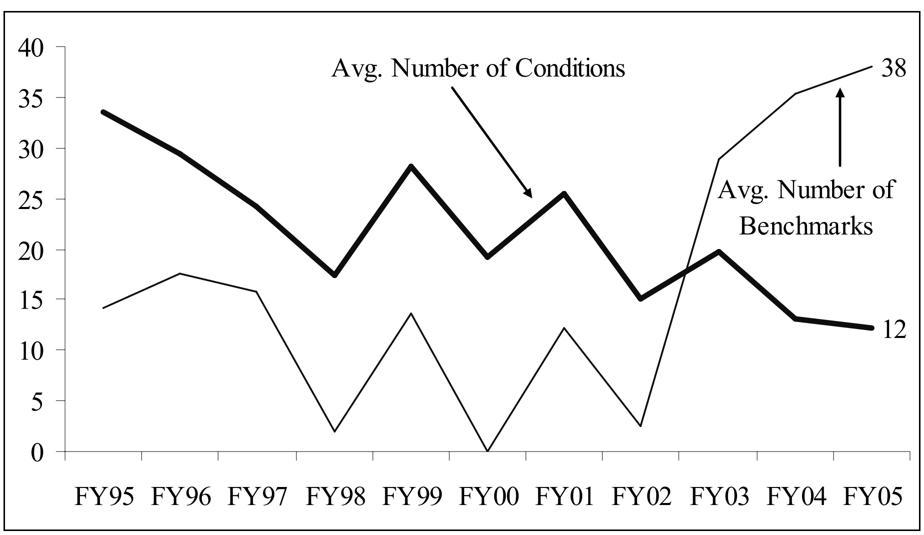
VI. CORE IDA COUNTRIES

Overview

80. Conditions in policy-based lending to IDA countries, as in other country groups, have been declining sharply, from 34 in FY95 to 12 in FY05. IDA countries, especially those on the higher end of the CPIA scale, increasingly receive programmatic loans, generally in the form of PRSCs. The emergence of PRSCs has also resulted in a large increase in the use of benchmarks to describe the program supported by the Bank (see Figure 62). Among the main findings are the following:

- Conditions in public sector governance and the social sectors are among the fastest growing conditionality to core IDA countries.
- The fall in macro/trade and financial sector and private sector development conditions coincides with the decline in overall conditions.
- Loans to better performing countries have fewer conditions, but they tend to have a higher number of benchmarks than loans to their less well performing counterparts.
- Lower performers have more public sector governance conditions but fewer social sector conditions.
- The content and complexity of public sector governance reforms deepens as performance increases.
- The thematic coverage of conditions varies by instrument and by country performance.
- The types of conditions vary with the content of conditions, the loan design used, and the stage in the programmatic series.
- Design conditions are increasing in IDA loans.

Figure 62. Trends in Conditions and Benchmarks in Loans to Core IDA Countries, FY95-05



Source: ALCID, World Bank.

A. Lending Trends and Approaches

81. During the last 10 years, policy-based lending to core IDA countries has doubled, from US$0.6 billion in FY95 for 11 operations to about US$1.2 billion in FY05 for 18 operations. IDA's lending now accounts for around 20 percent of World Bank policy-based lending and for around 37 percent of the policy-based loans approved, although it has been increasing in recent years (see Figure 63). The average size of IDA loans has fluctuated between US$60 million and US$120 million over the past 10 years, and it has declined in recent years to US$67 million.

82. ***Loan Concentration.*** Of the 30 countries with core IDA lending over the past decade, close to 20 percent of volume went to two countries, Tanzania and Uganda, and 50 percent went to seven countries (Bangladesh, Ethiopia, Ghana, Tanzania, Uganda, Vietnam, and Zambia).

83. ***Instruments.*** Close to 90 percent of loans approved in core IDA countries in FY05 were single-tranche loans (16 out of 18), compared to FY96 when all 10 loans approved were multitranche loans (see Figure 64). As in the case of core IBRD countries, this transition has been gradual. In this regard, the average size of single-tranche loans has also increased gradually, from around US$40 million during the second half of the 1990s to around US$80 million during the first half of the 2000s. By contrast, the average size of multitranche loans has been declining, from around US$80 million during the second half of the 1990s to US$33 million in FY05, after peaking in FY00 (see Figure 65).

Figure 63. Trends in the Share of IDA in Total Policy-Based Lending and in Total Number of Policy-Based Operations, FY95-05

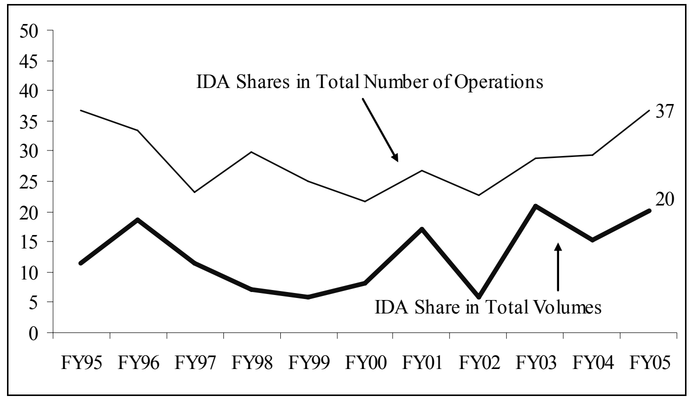


Figure 64. Trends in the Number of Single and Multiple Tranches in Core IDA Lending, FY95-05

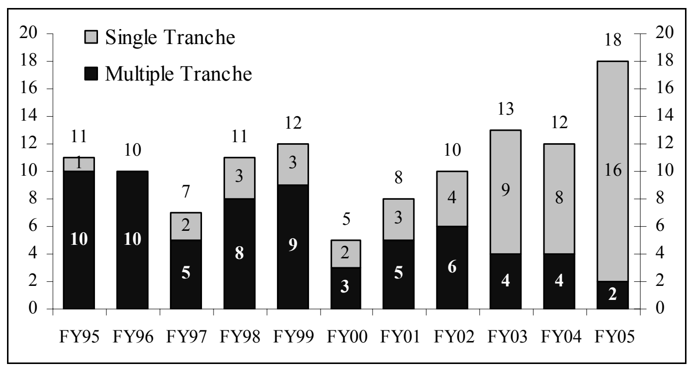
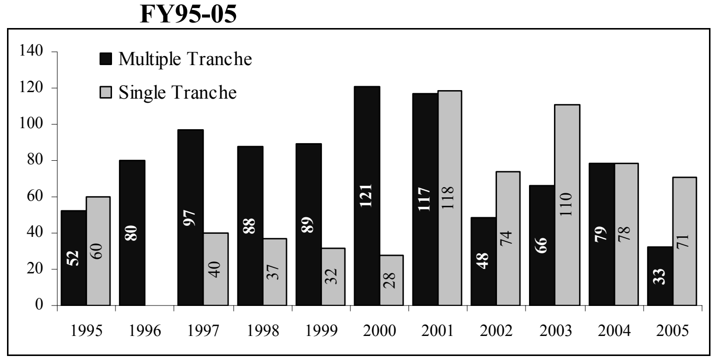


Figure 65. Trends in Avg. Lending Amounts by Tranches, FY95-05



Source: SAP Business Warehouse, World Bank.

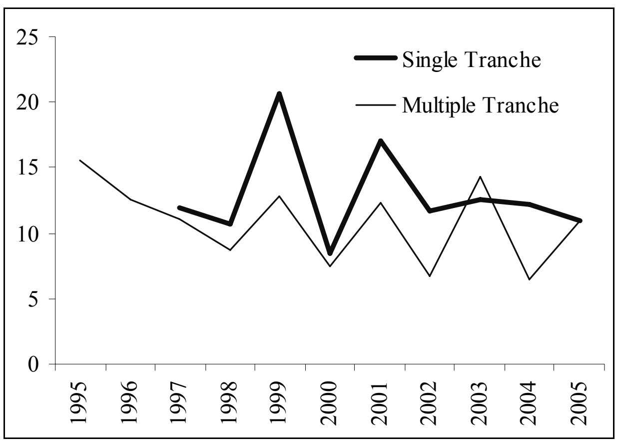
84. ***Programmatic Loans.*** In FY05, 15 out of 18 core IDA loans approved and 92 percent of their volumes were programmatic, compared with only 2 out of 10 in FY02. This growth is also reflective of the growth in PRSCs.

B. Number of Conditions

85. The number of conditions in policy-based lending to core IDA countries has declined, from around 34 conditions in FY95 to 19 in FY00, and to 12 in FY05 (see Figure 62). As the use of programmatic operations has increased, the use of benchmarks has been growing fast in recent years. The average number of benchmarks increased from 6 actions in FY02 to around 30-38 actions per loan in FY03-05. This trend coincided with the introduction of programmatic approaches (PRSCs) in FY00 in core IDA countries.

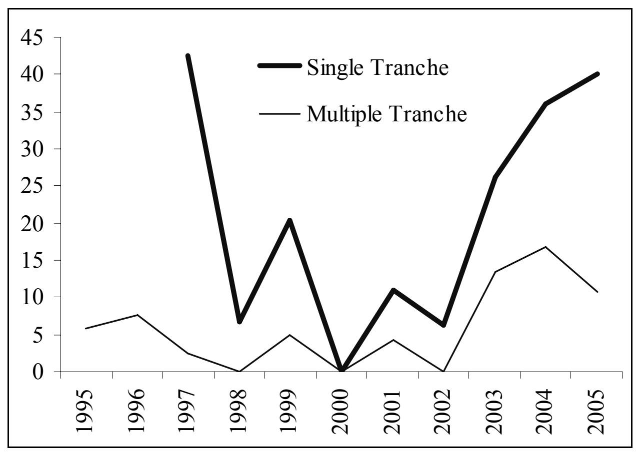
86. ***Single-Tranche/Multitranche Comparison.*** When corrected for the number of conditions per tranche, single-tranche loans have somewhat more conditions than multitranche loans (see Figure 66). Multitranche loans to core IDA countries have the fewest conditions among all the country groups. Single-tranche loans have on average a higher number of benchmarks than multitranche loans after correcting for the number of benchmarks per tranche (see Figure 67).

Figure 66. Trends in Conditions in Single- and Multitranche Loans, FY95-05
(corrected for the number of conditions per tranche)



Source: ALCID, World Bank.

Figure 67. Trends in Benchmarks in Single- and Multitranche Loans, FY95-05
(corrected for the number of conditions per tranche)



Source: ALCID, World Bank.

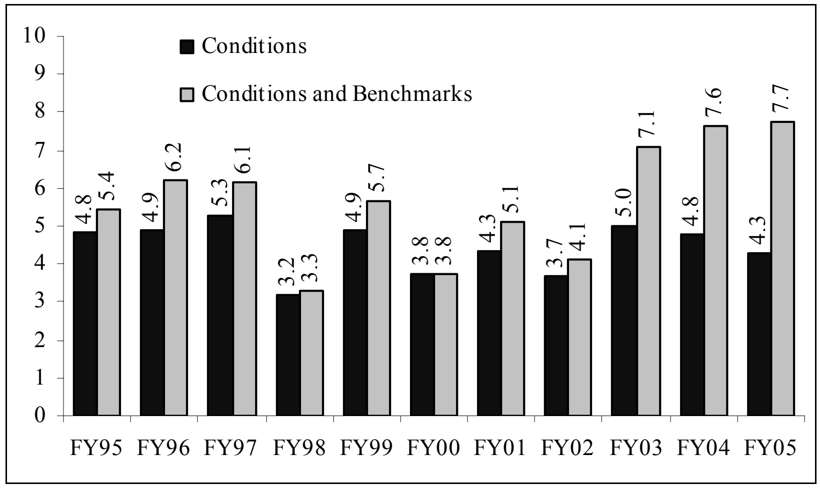
87. ***Benchmark Trends.*** The growth in benchmarks largely reflects the rising number of single-tranche loans associated with programmatic approaches (which typically include a larger number of thematic areas than nonprogrammatic loans). As described above, after a sharp decline in the use of benchmarks during FY98-00, benchmarks in single-tranche loans surged in FY01 and continued to grow in FY03 to 26 benchmarks and then to 40 benchmarks in FY05—reflecting growth in policy matrices describing Bank-supported programs under PRSCs. Benchmarks in multitranche loans did not experience a similar sharp growth.

C. Thematic Coverage

88. The thematic coverage of core IDA loans has remained stable at historical levels of four to five thematic areas per loan (with higher coverage in single-tranche and programmatic loans), albeit with sharply rising coverage—to around eight thematic areas—when benchmarks are factored in (see Figure 68).

89. ***Programmatic Loans.*** Thematic coverage appears to be growing with subsequent programmatic loans. In the case of three recent PRSCs series for Burkina Faso, Uganda, and Vietnam, there has been a constant increase in thematic coverage in the overall program (see Figure 69). New thematic areas are introduced as the agenda in the earlier thematic areas matures and shifts toward greater implementation. In the case of Burkina Faso and Uganda, the thematic coverage in the overall program doubled by the fourth loan in the series.

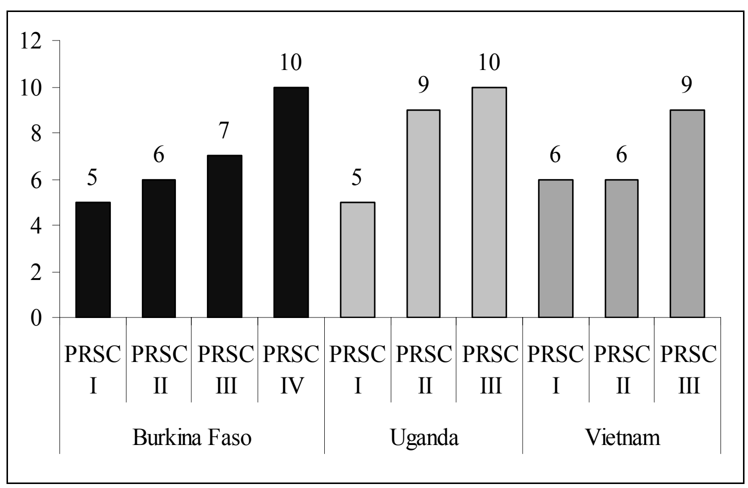
Figure 68. Trends in the Avg. Number of Themes, FY95-05



Source: ALCID, World Bank.

90. ***Expanded Coverage.*** In FY00, none of the core IDA loans had benchmarks outside the areas covered by conditions. By FY04, three-fourth of the loans included benchmarks in thematic areas not covered by conditionality. On average, between three and four thematic areas were covered only by benchmarks (see Table 5). In FY04-05 loans to Benin, Burkina Faso, Madagascar, and Uganda, for instance, benchmarks covered six or seven thematic areas in addition to the three to four areas covered by the conditions—implying total coverage of around 10 thematic areas and close to covering the full 11 thematic areas possible. This expansion in coverage is observable for almost all loans approved since FY03 (see Table 5), and there are areas where the Bank systematically uses benchmarks but rarely attaches conditions (e.g., rule of law, rural development, environment, and, to some extent, financial sector and private sector development).

Figure 69. Trends in Thematic Coverage in Selected Programmatic Series



Source: ALCID, World Bank.

Table 5. Trends in the Thematic Composition of PRSCs Approved in FY04 and FY05

Country		Economic Management	Environment and Natural Resource	Financial and Private Sector Dev.	Human Development	Public Sector Governance	Rule of Law	Rural Development	Social Development, Gender and Inclusion	Social Protection and Risk Management	Trade and Integration	Urban Development	Overall Number of Areas Covered	Number of Areas Covered by Benchmarks
Armenia	PRSC I		X	X	X	X	X	X			X		7	3
Albania	PRSC II	X		X	X	X	X	X		X			7	2
Albania	PRSC III			X	X	X	X	X		X	X		7	4
Benin	PRSC I	X	X	X	X	X	X	X	X	X			9	6
Burkina Faso	PRSC III	X	X	X	X	X	X	X					7	3
Burkina Faso	PRSC IV	X	X	X	X	X	X	X	X	X		X	10	6
Burkina Faso	PRSC V	X	X	X	X	X		X	X	X	X		9	5
Cape Verde	PRSC I	X			X	X	X		X	X			6	1
Ethiopia	PRSC I	X	X	X	X	X	X	X			X		8	0
Ethiopia	PRSC II		X	X	X	X	X	X	X	X	X	X	10	4
Ghana	PRSC II	X	X		X	X		X		X			6	3
Honduras	PRSC I	X	X	X	X	X	X	X	X	X			9	1
Madagascar	PRSC I	X	X	X	X	X	X	X	X	X	X	X	11	7
Mozambique	PRSC I		X	X	X	X	X		X	X	X		8	6
Nepal	PRSC I	X	X	X	X	X		X		X	X		8	4
Nicaragua	PRSC I	X	X	X	X	X	X	X	X	X	X	X	11	3
Rwanda	PRSC I		X	X	X	X	X	X	X	X	X		9	5
Senegal	PRSC I	X		X	X	X	X		X	X			7	4
Tanzania	PRSC II	X	X	X		X	X	X		X	X		8	3
Uganda	PRSC III	X	X	X	X	X	X	X	X	X		X	10	6
Uganda	PRSC IV		X	X	X	X	X	X	X		X		8	4
Vietnam	PRSC III	X	X	X	X	X	X	X		X	X		9	3
Vietnam	PRSC IV		X	X	X	X	X	X	X	X	X		9	3

Note: Boxes highlighted represent themes not covered by conditions but by benchmarks.

Source: ALCID, World Bank.

91. ***Trends in Public Sector Management Conditions.*** Public sector governance is the fastest growing area of conditionality in IDA loans. Ten years ago, conditions in public sector governance and the rule of law captured just 12 percent of conditions (4 out of 32 conditions on an average loan). Today, above 50 percent of loan conditions is captured by this group (6 out of 12 conditions on an average loan) and this trend is observed broadly across programmatic and nonprogrammatic loans and in single-tranche and multitranche loans alike (see Table 6). Half of the growth in conditions in public sector governance stems from public expenditure management, financial management, and procurement-related conditions and a quarter of the growth comes from public administration reforms. There is a growing trend in conditions to address rule of law and anticorruption issues. By contrast, the importance of tax policy and administration in public governance conditions fell in recent years—possibly reflecting closer Bank-Fund collaboration and a better division of labor.

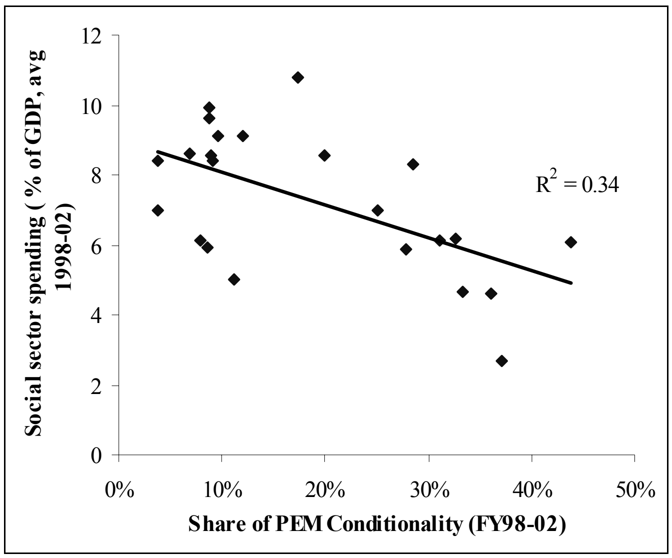
Table 6. Trends in the Share of Conditions and Benchmarks in Core IDA Loans by Themes, FY95-05

	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05 1/	Avg. FY00-05
Number of Loans	**12**	**10**	**7**	**11**	**12**	**4**	**9**	**10**	**13**	**13**	**16**	**11**
Conditions - Number of Conditions	**386**	**294**	**169**	**192**	**338**	**74**	**219**	**150**	**257**	**170**	**196**	**178**
in shares of Binding Conditions (%)												
Trade and Economic Management	23.8	21.8	24.9	11.5	13.3	8.1	9.6	8.0	4.3	7.6	8.7	7.7
Environment, Rural and Urban Development	8.5	4.8	4.7	5.2	9.2	2.7	4.6	8.7	7.0	7.6	2.0	5.4
Social Sectors	11.7	10.5	13.0	25.5	15.7	10.8	14.6	24.7	19.1	24.1	17.9	18.5
Human Development	7.0	4.4	8.3	17.2	2.7	1.4	7.8	20.7	13.2	20.0	13.3	12.7
Social Development, Gender and Inclusion	0.3	1.4	1.2	0.0	2.1	0.0	0.0	0.0	0.0	0.6	0.5	0.2
Social Protection and Risk Management	4.4	4.8	3.6	8.3	10.9	9.5	6.8	4.0	5.8	3.5	4.1	5.6
Financial and Private Sector Development	44.0	38.4	31.4	45.3	32.2	31.1	29.2	29.3	20.6	14.1	18.9	23.9
Public Sector Governance and Rule of Law	11.9	24.5	26.0	12.0	29.6	47.3	42.0	29.3	49.0	46.5	52.6	44.4
of which:												
Public expenditure, financial management and procureme	4.4	6.1	16.0	3.1	9.8	14.9	21.5	15.3	21.0	22.4	25.0	20.0
Administrative and civil service reform	0.3	8.2	0.6	2.6	9.2	1.4	4.1	6.0	7.0	9.4	9.2	6.2
Tax policy and administration	3.9	6.1	6.5	3.6	3.3	16.2	6.4	2.7	3.1	4.7	1.5	5.8
Decentralization	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.7	0.0	2.4	2.6	0.9
Rule of Law	0.5	0.7	0.6	0.0	3.0	4.1	1.8	0.7	4.7	2.9	6.6	3.5
Other public sector governance, accountability/anti-corru	2.8	3.4	2.4	2.6	4.4	10.8	8.2	4.0	13.2	4.7	7.7	8.1
Other accountability/anti-corruption	0.0	0.0	1.2	0.0	1.2	5.4	0.9	1.3	4.3	2.4	4.1	3.1
Other public sector governance	2.8	3.4	1.2	2.6	3.3	5.4	7.3	2.7	8.9	2.4	3.6	5.0
Benchmarks - Number of Milestones	**198**	**176**	**110**	**21**	**163**		**98**	**25**	**375**	**467**	**605**	**314**
in shares of Milestones (%)												
Trade and Economic Management	14.6	12.5	15.5	4.8	4.3	-	3.1	16.0	5.1	4.1	6.0	6.8
Environment, Rural and Urban Development	8.1	10.2	3.6	0.0	7.4	-	11.2	24.0	12.3	13.9	10.7	14.4
Social Sectors	13.6	17.6	6.4	23.8	12.9	-	24.5	20.0	22.7	17.8	25.5	22.1
Human Development	10.1	10.2	2.7	0.0	1.8	-	17.3	16.0	13.1	10.9	14.9	14.4
Social Development, Gender and Inclusion	0.0	0.0	0.0	0.0	6.7	-	0.0	0.0	1.9	2.4	3.0	1.4
Social Protection and Risk Management	3.5	7.4	3.6	23.8	4.3	-	7.1	4.0	7.7	4.5	7.6	6.2
Financial and Private Sector Development	36.9	34.1	41.8	66.7	19.0	-	34.7	12.0	15.2	12.0	8.6	16.5
Public Sector Governance and Rule of Law	26.8	25.6	32.7	4.8	56.4	-	26.5	28.0	44.8	52.2	49.3	40.2
of which:												
Public expenditure, financial management and procureme	6.1	8.0	11.8	4.8	23.3	-	4.1	16.0	23.2	27.2	19.2	17.9
Administrative and civil service reform	2.0	5.1	5.5	0.0	18.4	-	1.0	12.0	7.2	7.3	13.1	8.1
Tax policy and administration	12.1	9.1	10.0	0.0	6.7	-	7.1	0.0	2.9	3.0	2.6	3.1
Decentralization	0.0	0.0	0.9	0.0	1.2	-	0.0	0.0	0.3	3.2	1.7	1.0
Rule of Law	1.0	1.1	0.9	0.0	4.3	-	4.1	0.0	2.7	4.7	6.6	3.6
Other public sector governance, accountability/anti-corru	5.6	2.3	3.6	0.0	2.5	-	10.2	0.0	8.5	6.9	6.1	6.3
Other accountability/anti-corruption	0.0	0.0	0.0	0.0	0.0	-	0.0	0.0	4.0	2.6	2.0	1.7
Other public sector governance	5.6	2.3	3.6	0.0	2.5	-	10.2	0.0	4.5	4.3	4.1	4.6
Conditions and Benchmarks	**584**	**470**	**279**	**213**	**501**	**74**	**317**	**175**	**632**	**637**	**801**	**439**
in shares of Conditions and Milestones (%)												
Trade and Economic Management	20.7	18.3	21.1	10.8	10.4	8.1	7.6	9.1	4.7	5.0	6.6	6.9
Environment, Rural and Urban Development	8.4	6.8	4.3	4.7	8.6	2.7	6.6	10.9	10.1	12.2	8.6	8.5
Social Sectors	12.3	13.2	10.4	25.4	14.8	10.8	17.7	24.0	21.2	19.5	23.6	19.5
Human Development	8.0	6.6	6.1	15.5	2.4	1.4	10.7	20.0	13.1	13.3	14.5	12.2
Social Development, Gender and Inclusion	0.2	0.9	0.7	0.0	3.6	0.0	0.0	0.0	1.1	1.9	2.4	0.9
Social Protection and Risk Management	4.1	5.7	3.6	9.9	8.8	9.5	6.9	4.0	7.0	4.2	6.7	6.4
Financial and Private Sector Development	41.6	36.8	35.5	47.4	27.9	31.1	30.9	26.9	17.4	12.6	11.1	21.7
Public Sector Governance and Rule of Law	17.0	24.9	28.7	11.3	38.3	47.3	37.2	29.1	46.5	50.7	50.1	43.5
of which:												
Public expenditure, financial management and procureme	5.0	6.8	14.3	3.3	14.2	14.9	16.1	15.4	22.3	25.9	20.6	19.2
Administrative and civil service reform	0.9	7.0	2.5	2.3	12.2	1.4	3.2	6.9	7.1	7.8	12.1	6.4
Tax policy and administration	6.7	7.2	7.9	3.3	4.4	16.2	6.6	2.3	3.0	3.5	2.4	5.7
Decentralization	0.0	0.0	0.4	0.0	0.4	0.0	0.0	0.6	0.2	3.0	1.9	0.9
Rule of Law	0.7	0.9	0.7	0.0	3.4	4.1	2.5	0.6	3.5	4.2	6.6	3.6
Other public sector governance, accountability/anti-corru	3.8	3.0	2.9	2.3	3.8	10.8	8.8	3.4	10.4	6.3	6.5	7.7
Other accountability/anti-corruption	0.0	0.0	0.7	0.0	0.8	5.4	0.6	1.1	4.1	2.5	2.5	2.7
Other public sector governance	3.8	3.0	2.2	2.3	3.0	5.4	8.2	2.3	6.3	3.8	4.0	5.0

Source: ALCID, World Bank.

92. ***Poverty Link.*** In IDA credits, public expenditure management (PEM) conditions are used more in countries with lower social spending, lower social conditions, and higher poverty. When analyzing the relationship between the share of PEM conditions and the share of social spending as percent of GDP, adult literacy rates, child mortality rates, and poverty headcount during the 1998-02 period, countries with relatively lower social spending are also the countries with relatively more PEM conditions, lower adult literacy, and higher child mortality rates and poverty. Figure 70 shows the relationship of social sector spending as percentage of GDP with the share of PEM conditions in 27 IDA loans approved between 1998 and 2002 (where data was available). The share of fiduciary conditions is the highest in fragile environments.

Figure 70. PEM Conditions and Social Spending in Selected IDA Countries, 1998-02

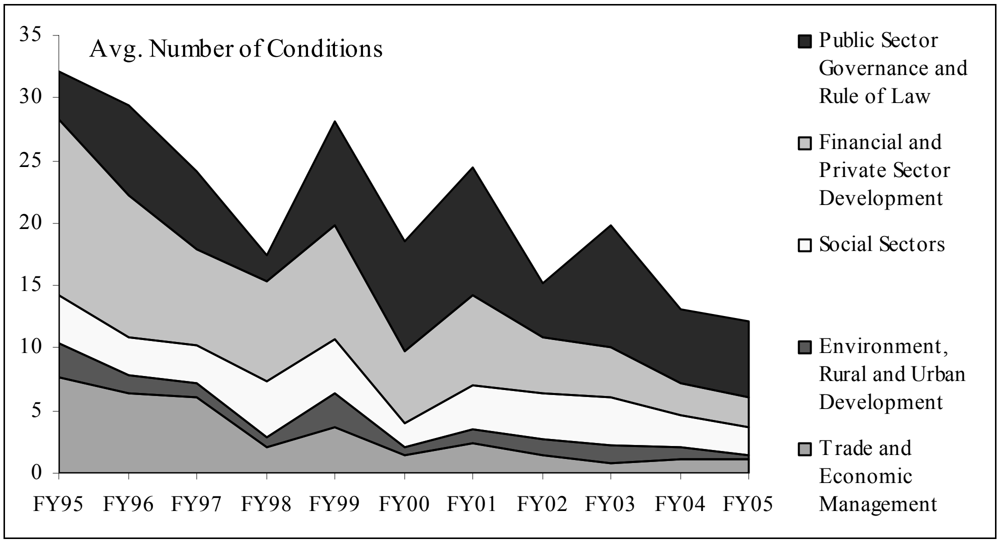


Source: ALCID, World Bank and IMF Government Finance Statistics.

93. ***Sectors with Growing Conditionality.*** The share of social sector conditions has grown from less than 12 percent of conditions in FY95 to around 20 percent in FY05. However, there are substantially higher social sector measures contained in benchmarks than in conditions. For instance, in recent loans, conditions in the social sectors focused less on social protection than in benchmarks, while both groups emphasized primarily human development issues (education and health). Conditions in single-tranche and programmatic loans contain slightly higher social sector content (around 21-23 percent) compared with multitranche nonprogrammatic loans (15-17 percent). Also, the first phase programmatic loans (PRSCs) addresses public sector governance and social sectors to a higher degree than previous structural adjustment loans. The coverage of subsequent programmatic loans tends to be larger than the original or the previous loan.

94. ***Sectors with Declining Conditionality.*** The number of conditions in macro/trade and financial sector and PSD areas fell from 22 out of 32 conditions on average in FY95 to 3 or fewer out of 12 conditions in FY05 loans, reflecting the overall decline in conditions. Conditions in public sector governance and the social sector, however, maintained their relative presence on average in recent years (at around 8-9 conditions out of 12-15 conditions) (see Figure 71). Multitranche and nonprogrammatic loans on average contain relatively higher shares of financial and PSD conditions than single-tranche and programmatic loans.

Figure 71. Trends in the Composition of Conditions by Themes, FY95-05



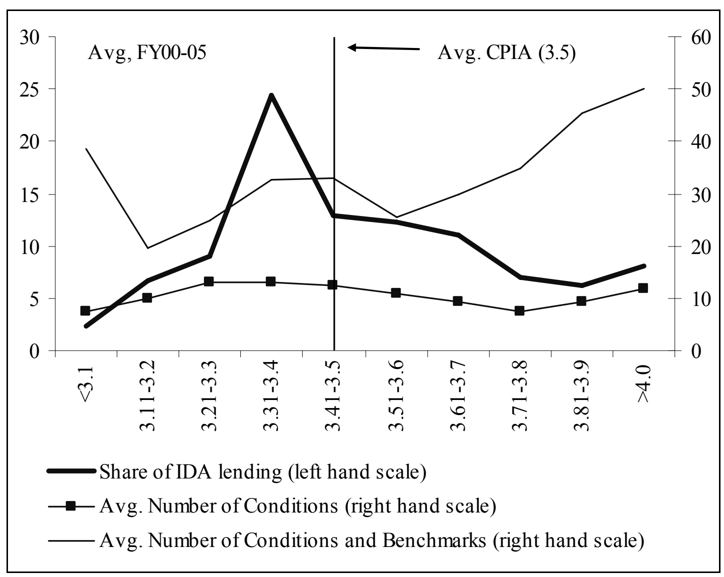
Source: ALCID, World Bank.

95. ***Economic Management Conditions.*** Where there were economic management conditions, half of them focused on debt management (e.g., national debt strategy, prudential debt contracting, and tracking/accounting of HIPC debt relief funds) and the other half on maintenance of a satisfactory macroeconomic framework. Trends in trade-related conditions followed a selected few country cases—export development and trade facilitation conditions to Vietnam and Ethiopia accounted for half of the conditions in trade to core IDA countries.

D. Selectivity

96. The number of conditions declines slightly with improving performance up to a point, but returns to average levels for better performers. About half of the lending to core IDA countries during FY00-05 went to above average performing countries (CPIA above 3.5). There is evidence that the number of loan conditions declines with performance (see Figure 72), but increases for the highest performers (CPIA 3.9-4.0, or above). Countries reaching a CPIA of 4.0 during the period on average received 8 percent of the IDA lending and their loans contained some 12 conditions, similar to the 12 conditions in average performers. However, for countries with a CPIA rating between 3.5 and 3.8, the number of conditions was lower than average. The lowest performers (CPIA below 3.2)

Figure 72. Share of Lending and Conditions and Benchmarks by Performance, FY00-04



Source: ALCID, World Bank.

have fewer conditions than average IDA countries. Benchmarks were used increasingly for better performers, reflecting the concentration of PRSCs in this group of countries.

97. ***Performance Factor.*** Poorer performers have more public sector governance conditions but less social sector conditions than their better performing counterparts. Over the past five years, 60 percent of conditions in lower performing core IDA countries were in public sector governance areas, compared with 40 percent or less in average and higher performing countries. Social sector conditions were used less in lower performing countries, accounting for around 10-15 percent of conditions compared with around 30 percent in higher performing countries.

98. ***Performance and Public Sector Governance.*** The content and complexity of public sector governance reforms deepen with higher performance. Public expenditure conditions during the 1980s focused on the composition of expenditures between current and capital allocations. During the 1990s, they focused mostly on expenditures for basic services and, in particular, on social sector spending. But addressing public sector inefficiency, rather than expenditure composition or piecemeal reforms in certain sectors, remained a challenge. Public sector inefficiencies tracked back to fundamental issues of governance, including lack of participatory mechanisms and institutions for public decisionmaking, weak legal institutions, ambiguities regarding the role of the state, and lack of accountability.[8] As a result, toward the end of the 1990s, public expenditure reforms began to take a governance perspective and to move away from the "command and control" culture toward a "service delivery" orientation. The rapid growth in public sector governance conditions during the early 2000s reflects this trend. However, there is a marked difference in the content of this condition across country performance. Based on CPIA ratings, core IDA countries can be placed into three groups (CPIA <= 3.2, CPIA = 3.3-3.5, or CPIA >=3.6), permitting exploration of conditions across several dimensions, including financial planning, MTEF and budgeting, auditing, financial management and procurement, and public accountability and disclosure (see Table 7).[9] There were little or no accountability/disclosure measures in recent loans to below average performers, while for average performers conditions focused on allowing public hearings and discussion at parliaments of budgets, including steps to disclose government budgets and publish procurement practices indicators and bulletins.

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[8] Jeff Huther, Sandra Roberts, and Anwar Shah, *Public Expenditure Reform Under Adjustment Lending: Lessons from World Bank Experiences*, World Bank Discussion Paper No. 382, 1997.

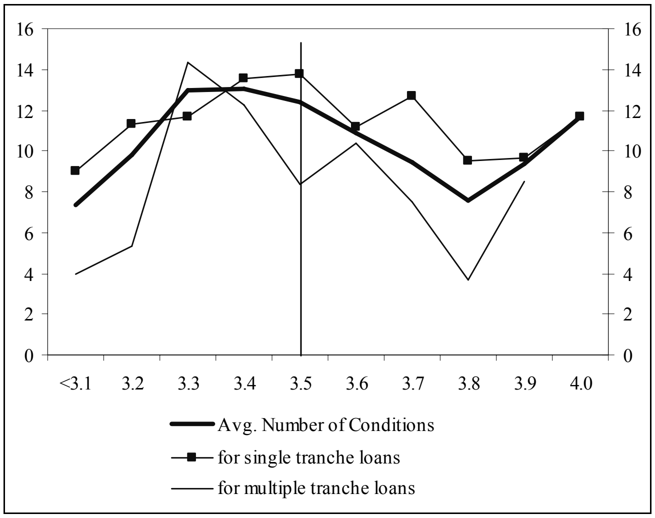
[9] In financial planning and auditing, for instance, conditions in below average performers address basic governance reforms (simple treasury reporting and some auditing) while in average performers it focuses on establishing institutions and systems (financial planning and auditing departments), and in above average performers it focuses on government-wide accounting systems and laws on internal audit. Similarly in budgeting reforms, below average performers start by piloting the MTEF approach in the social sectors, average performers expand it to the rest of government, and above average performers adopt and evaluate their budget following the MTEF approach. In the case of financial management and procurement, below average performers are beginning to prepare CFAAs/CPARs and adopt basic regulatory reforms, while average performers are implementing some of the key financial management and procurement regulations, and above average performers are preparing the manuals and procedures to operationalize regulations.

Table 7. Public Expenditure, Financial Management, and Procurement Conditions by Country Performance, FY00-05

CPIA 3.2 or less	CPIA 3.3-3.5	CPIA 3.6 or better
Financial Planning		
Preparing basic treasury transaction statements on a quarterly or monthly basis and links between the current and investment budgets.	Establishing financial planning departments, instituting training, and procedures/systems for preparing regular financial plans, at the central and decentralized level (monthly report and daily treasury transaction reports).	Unifying the accounting systems of the State Budget and the State Treasury.
MTEF and Budgeting		
Piloting MTEF in the social sectors and begin to align the budget with the PRSP.	Deepening and extending MTEF approach to all key ministries and increasingly adopt program budgeting.	Adopt and evaluate budgets based on MTEF and in line with PRSP priorities, and preparation of annual PRSP progress reports.
Auditing		
Strengthening audit department and carrying out selective audits.	Separating audit and accounting departments and timely audits of central government financial statements based on international accounting standards.	Preparation of laws on internal audit.
Financial Management and Procurement		
Carry out CFAA/CPAR and implement basic public financial management and public procurement reforms, including submission of public procurement code.	Enact procurement laws and implementing regulations and CFAA/CPAR/PER action plans, including adopting standardized bidding documents. Extend financial management reforms to all levels of government and adopt mechanisms or enable legislation to assign expenditure and revenue responsibilities to local governments.	Continue to implement CFAA/CPAR recommendations: creating government property accounting systems and fully developing procurement procedures and documentation. Prepare concession and leasing contracts and amend local government laws to allow procurement and asset disposal.
Public Accountability and disclosure		
None.	Public hearings and discussion at parliaments of budgets, including steps to disclose government budgets.	Publish procurement practices indicators and bulletins to ensure competition in selecting agents.

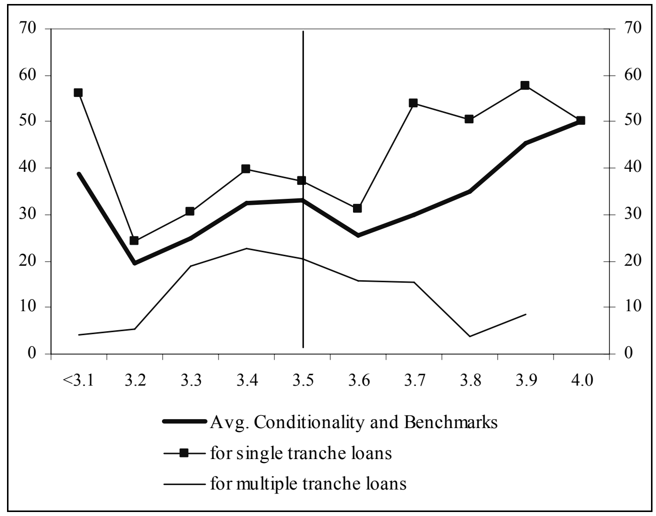
99. ***Loan Design.*** As noted above, on average, conditionality is lower in the lower end of the performance scale and for countries with a CPIA between 3.5 and 3.8 (see Figure 73). Regarding loan design, across the country performance spectrum, single-tranche loans have on average more conditions than multitranche loans. Single-tranche loans are driving the increase of conditions with performance. Lastly, when considering conditions and benchmarks together, it is again evident that benchmarks are used more heavily among better performers (see Figure 74).

Figure 73. Conditions in Single- and Multitranche Loans by Country Performance, FY00-05



Source: ALCID, World Bank.

Figure 74. Conditions and Benchmarks in Single- and Multitranche Loans by Country Performance, FY00-05

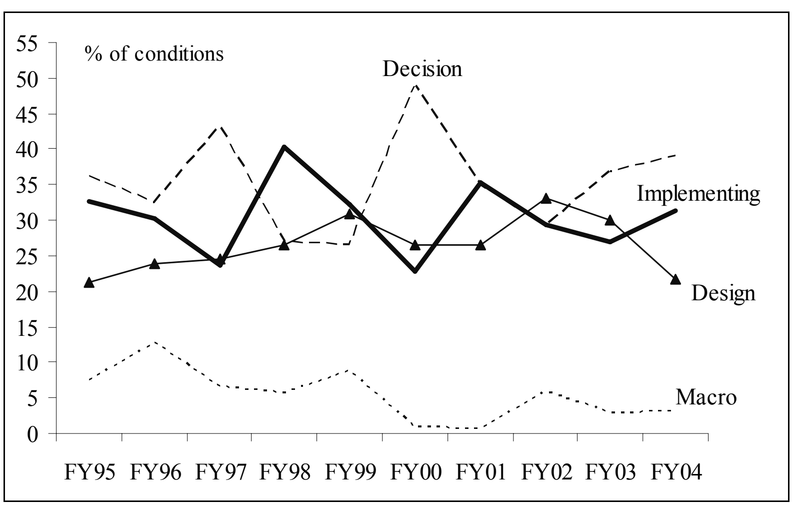


Source: ALCID, World Bank.

E. Types of Conditions

100. Design conditions are declining in IDA loans in recent years. The proportion of design conditions in IDA loans increased from around 20 percent in FY95 to more than 30 percent by FY02, and has been declining in recent years to 22 percent in FY04 (see Figure 75). The share of implementation and decision conditions has fluctuated, but without any strong trend. There is some evidence that benchmarks focus more heavily on design than do conditions, and that therefore conditions and benchmarks are used differently. Benchmarks are often complementing a reform process, and are more heavily focused on preparatory stages, with conditions picking up critical decision and implementation steps.

Figure 75. Trends in Conditions by Types, FY95-04

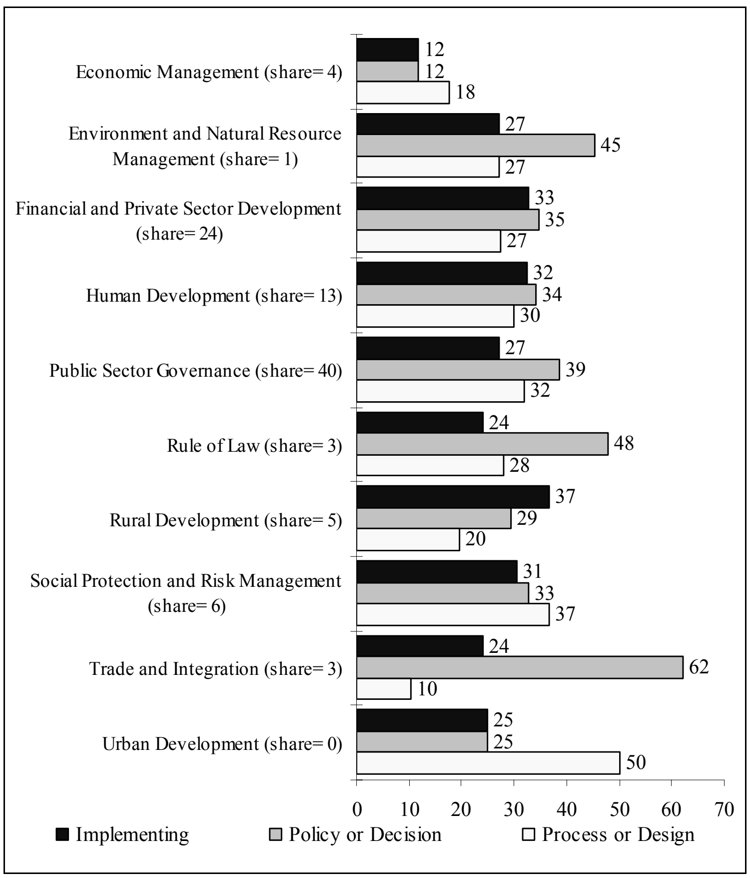


Source: ALCID, World Bank.

101. ***Types of Conditions: Comparison.*** Some 39 percent of conditions in public sector governance (which accounts for 45 percent of all conditions in loans to core IDA countries) are decision or policy type conditions, reflecting the importance of the adoption, entry into force, or enactment of laws, decrees, directives, amendments, or regulations for improved public expenditure management, governance, and fiduciary arrangements (see Figure 76). Design conditions follow in importance with 32 percent of the conditions, with implementation conditions at 27 percent. Overall in the social sectors, conditions in social protection and risk management tend to be design or process driven, while conditions in human development areas (health and education) tend to be decision types. Rural development conditions have the highest component of implementing conditions of all sectors and the lowest component (after trade) of design conditions. Trade and environmental conditions, on the other hand, are both highly driven by decision or policy type conditions, in part reflecting the nature of one-off trade policy reforms. Urban development conditions are mostly process conditions—reflecting the longer term and institutional nature of reforms.

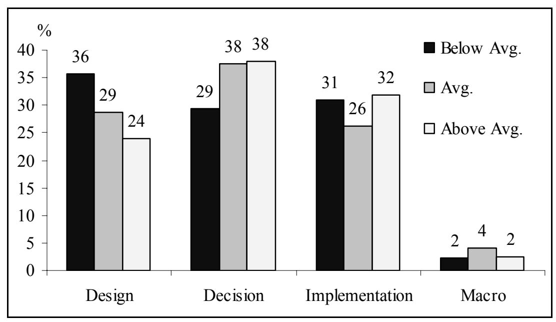
102. ***Country Performance Factor.*** Below average performers have on average a higher proportion of design type conditions than good or above average performers (see Figure 77). They also have a lower proportion of decision type conditions than the others. This pattern reflects the struggle in environments with lower capacity, where the design of reform processes or policy changes can be a critical step.

Figure 76. Trends in the Types of Conditions by Themes, FY00-04 (average, in percent)



Source: ALCID, World Bank.

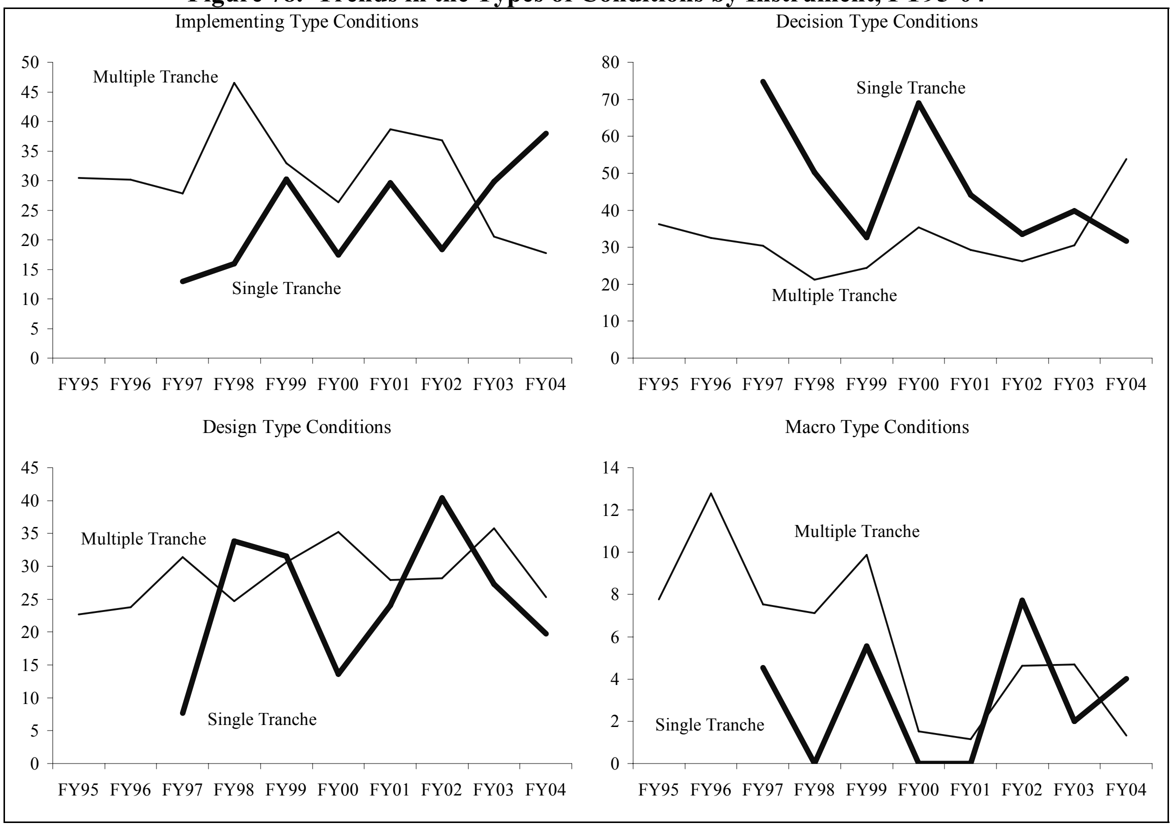
Figure 77. Types of Conditions by Country Performance, FY00-04



Source: ALCID, World Bank.

103. ***Loan Design Factor.*** The share of implementation conditions in single-tranche loans has been growing in recent years, to around 40 percent in FY04 compared with less than 15 percent in FY97, while it has declined in multitranche loans over the same period, from around 50 percent to less than 20 percent (see Figure 78). Rising implementation shares could signify the coming to maturation of a first set of PRSCs (see below). Decision type conditions declined in importance in single-tranche loans and have increased in multitranche loans.

Figure 78. Trends in the Types of Conditions by Instrument, FY95-04

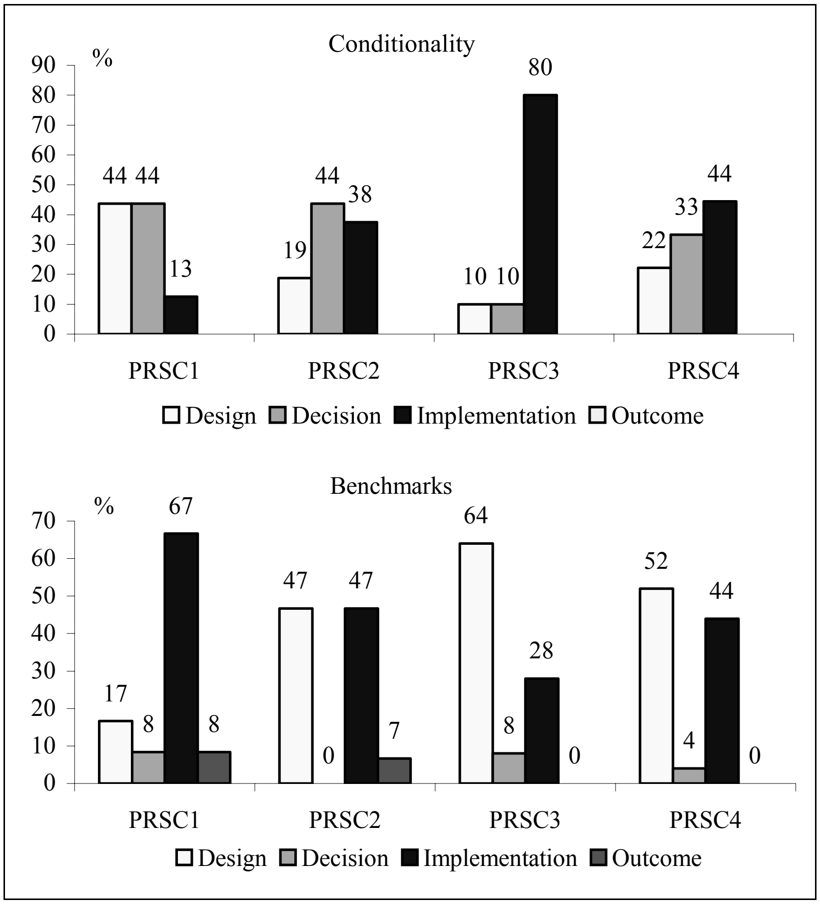


Source: ALCID, World Bank.

104. ***Programmatic Stage Factor.*** The types of conditions vary by the stage in the programmatic series—as exemplified by the case of Burkina Faso's PRSCs. The series of Burkina Faso PRSCs provide an example of a shift in the mode of program implementation with the maturing of the programmatic series (see Figure 79). At the outset, conditions in Burkina's PRSC1 focused mostly on design and decision type conditions (44 percent each)—reflecting the need for analytic work and institutional set-up in putting in place the initial set of reforms to be supported by the Bank in the medium term. Implementation and outcomes were largely covered by benchmarks. While continuing to emphasize policy conditions at the core, conditions in PRSC2 shifted the focus toward implementation, increasing its share in total conditions from 13 percent to 38 percent. At the same time, the emphasis of process conditions declined in conditions, but increased markedly in benchmarks, from 17 percent in PRSC1 to 47 percent of benchmarks in PRSC2. By PRSC3, the nature of the reform program had shifted almost entirely to implementation (80 percent of conditions), while benchmarks continued to show large increases in design type conditions, reaching 64 percent of the total number of the benchmarks, as the ground was laid for future reforms. PRSC4, building on this work, then marked a break in the programmatic series. It incorporated new sectoral elements to the medium-term program as the

initial program matured. Thus, PRSC4 contained a mix of program objectives (old and new), which resulted in broader program coverage and expanded benchmarks. In general, the Burkina Faso experience shows an increasing pattern of treating design matters mostly as benchmarks and not as conditions, in line with the use of conditions for critical actions.

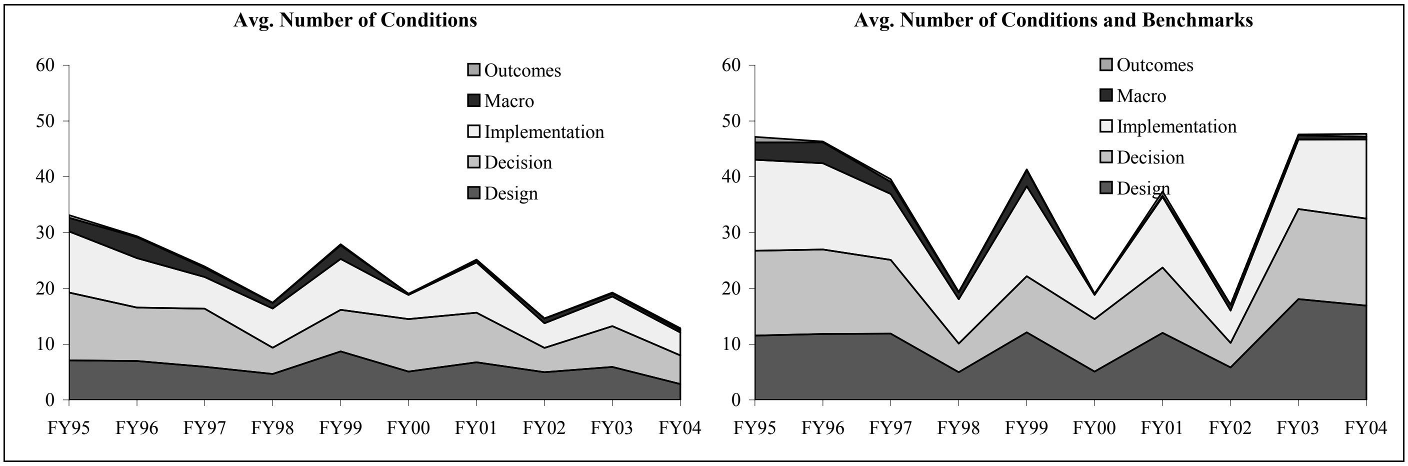
Figure 79. Burkina Faso: Types of Conditions and Benchmarks along the Programmatic Series (in percent of conditions)



Source: ALCID, World Bank.

105. ***Benchmarks.*** As conditions have declined, so have all types of conditions in a broadly proportional manner. However, as is evident from Figure 80, the increasing emphasis on design work in recent years has resulted in higher benchmark trends.

Figure 80. Trends in Number of Conditions by Types and by Tranches, FY95-04



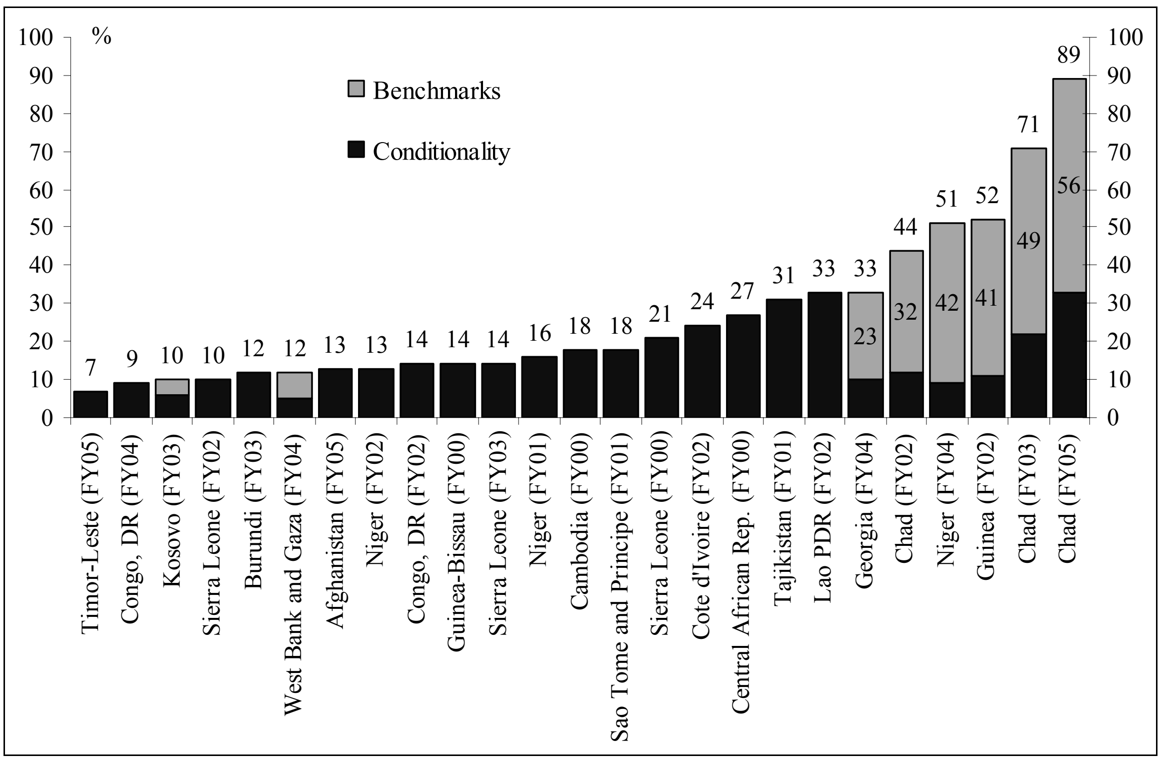
Source: ALCID, World Bank.

VII. LOW-INCOME COUNTRIES UNDER STRESS (LICUS)

Overview

106. The number of conditions in policy-based operations to LICUS countries has declined from 32 on average in FY95 to 13 in FY05. Conditions are increasingly focused on a few reform areas and a few critical actions. However, in recent years the Bank has made increasing use of benchmarks. This growth is mostly evident in single-tranche loans and strictly contained in a select number of countries—in essence the growth appears to be country-specific (see Figure 81). It is also particularly noteworthy that conditions in public sector governance areas have grown rapidly in recent years, replacing to some extent conditions for private sector development, social sectors, and rural/urban development, all of which appear to be declining in importance. There are some common elements found in loan conditions to address minimum levels of fiduciary controls for LICUS countries. Also there are some patterns in the content of conditions, which indicate deepening in reforms as country performance improves, particularly in public sector governance issues, rather than beginning early with the broadening of reform areas. The different types of conditions also changed in line with the recent decline in conditions—process or design conditions have grown in single-tranche loans and in social sector and public sector governance conditions, and implementation conditions are more important in poorer performing LICUS than in better performing LICUS countries.

Figure 81. Conditions and Benchmarks in LICUS Loans, FY00-05

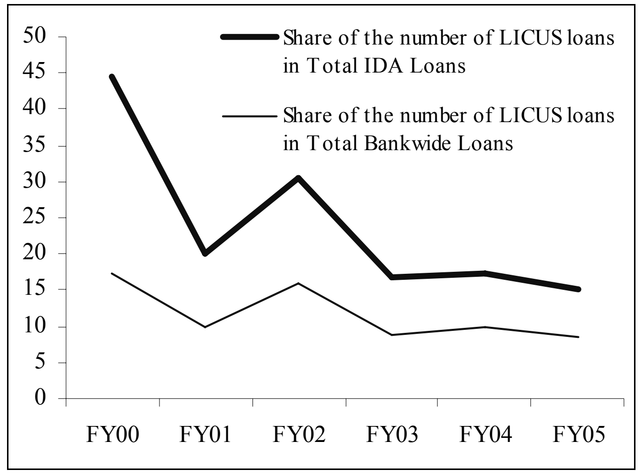


Source: ALCID, World Bank.

A. Lending Trends and Approaches

107. More than 20 percent of IDA policy-based loans go to LICUS countries. There were 27 loans approved to LICUS countries in the FY00-05 period and 24 loans approved in the previous five years to the same group of countries (see Figure 82). Four countries (Chad, Côte d'Ivoire, Georgia, and Niger) have received close to half of the loans going to LICUS countries over the past 10 years. On average, there are between three and seven DPLs approved per year, or around 24 percent of IDA loans or 12 percent of Bankwide DPLs approved on a yearly basis (see Table 8).

Figure 82. Trends in the Share of LICUS Loans in Total IDA Loans, FY00-05



Source: SAP Business Warehouse, World Bank.

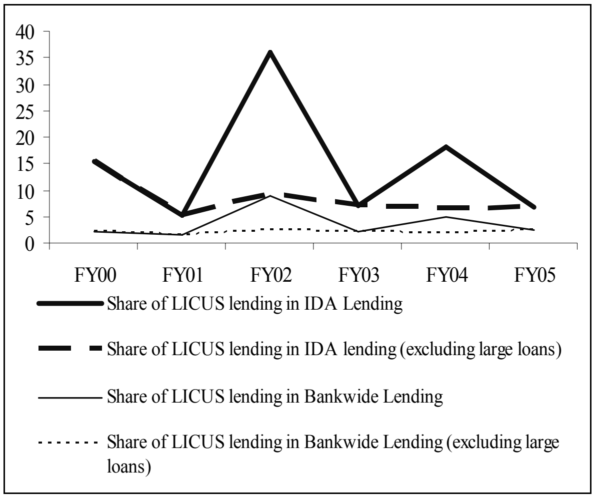
Table 8. Number of LICUS Loans, FY95-05

Country	FY95	FY96	FY97	FY98	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY95-05
Afghanistan											1	1
Burundi									1			1
Cambodia		1				1						2
Central African Republic						1						1
Chad		1	1		1			1	1		1	6
Congo, DR								1		1		2
Cote d'Ivoire	1	2		2				1				6
Georgia	1	1		1	2					1		6
Guinea	1			1				1				3
Guinea-Bissau						1						1
Kosovo									1			1
Lao PDR		1						1				2
Niger			1		1		1	1		1	1	6
Sao Tome and Principe							1					1
Sierra Leone						1		1	1		1	4
Solomon Islands					1							1
Tajikistan			1	1	1		1					4
Timor-Leste											1	1
Togo		1										1
West Bank and Gaza										1		1
FY Total	**3**	**7**	**3**	**5**	**6**	**4**	**3**	**7**	**4**	**4**	**5**	**51**

Source: SAP Business Warehouse, World Bank.

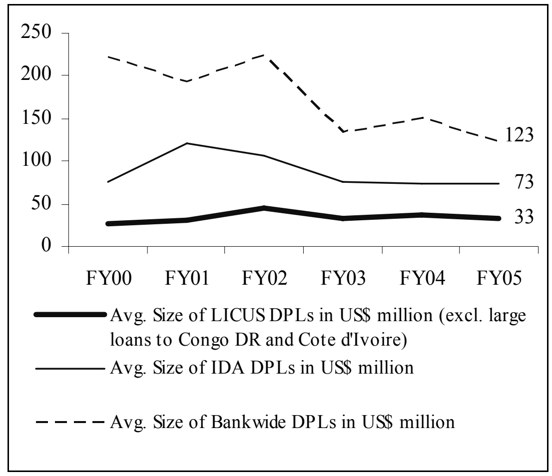
108. **Lending Volumes.** In terms of lending volumes, LICUS lending is small (during FY00-05, 15 percent of IDA lending and 4 percent of total Bankwide lending). Furthermore, if one excludes two large loans to Congo DR (US$450 million in FY02 and US$200 million in 2004) and one to Côte d'Ivoire ($200 million in 2002), these volume ratios decline to 8 percent of IDA lending and 2 percent of Bankwide lending, respectively (see Figure 83). LICUS loans on average are less than half the size of typical IDA loans (see Figure 84).

Figure 83. Trends in the Share of LICUS Lending in Total IDA Lending, FY00-05



Source: SAP Business Warehouse, World Bank.

Figure 84. Trends in Size of LICUS Loans, FY0-05



Source: SAP Business Warehouse, World Bank.

109. ***LICUS Experience.*** In lending to Afghanistan in FY05, the Bank explicitly presented the program following a standard programmatic approach. The coverage and scope of the program matrix was broad, reflecting the large reform agenda in support of the government's development program. Conditions were limited to 10 key actions drawn from the larger donor-supported program matrix. Some 11 triggers or indicative expected prior actions or benchmarks were agreed to help assess future support, with the understanding that they can and will be adapted as circumstances warrant. Other countries have used programmatic approaches, such as a series of structural adjustment credits for Chad or the support program for Timor-Leste. These examples illustrate the early Bank experience in the practice of triggers and programmatic approaches in LICUS countries and indicate the degree of flexibility the Bank has in designing programmatic loans.[10]

B. Number of Conditions

110. The use of conditions in LICUS countries has declined over the past six years. Similar to core IDA countries, the increasing use of programmatic single-tranche operations has also resulted in an increased use of benchmarks in recent years, from zero in FY00 and FY01 to around 18-20 conditions per loan in FY04-05 (see Figure 85). However, it is also noteworthy that a similar number of benchmarks were previously used in FY95.

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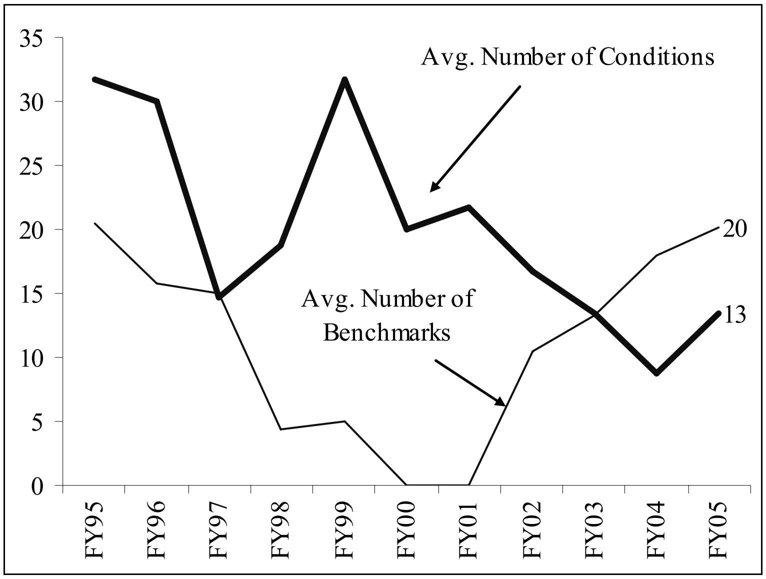
[10] See *Good Practice Note on Development Policy Operations and Program Conditionality in Fragile States*, OPCS, World Bank, June 2005.

Figure 85. Trends in Conditions and Benchmarks in LICUS Countries, FY95-05



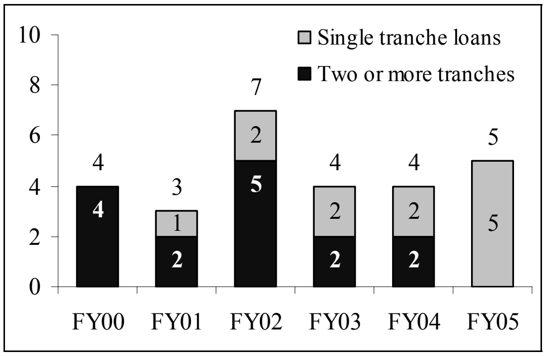
Source: ALCID, World Bank.

111. ***Factors at Play.*** There reasons for the increase in the use of benchmarks, include the following:

- ***Policy-based loans in LICUS countries are increasingly single-tranche loans.*** Most single-tranche loans have indicative benchmarks in addition to conditions. In 8 of the 12 single-tranche loans approved during FY00-05, there were benchmarks in addition to conditions. Only 1 of the 15 multitranche loans used benchmarks. This reflects a greater need for setting out a comprehensive program in single-tranche loans than in multitranche loans. It is expected that single-tranche operations will remain a preferred loan design in the future; all LICUS policy-based loans in FY05 were single-tranche operations (see Figure 86).

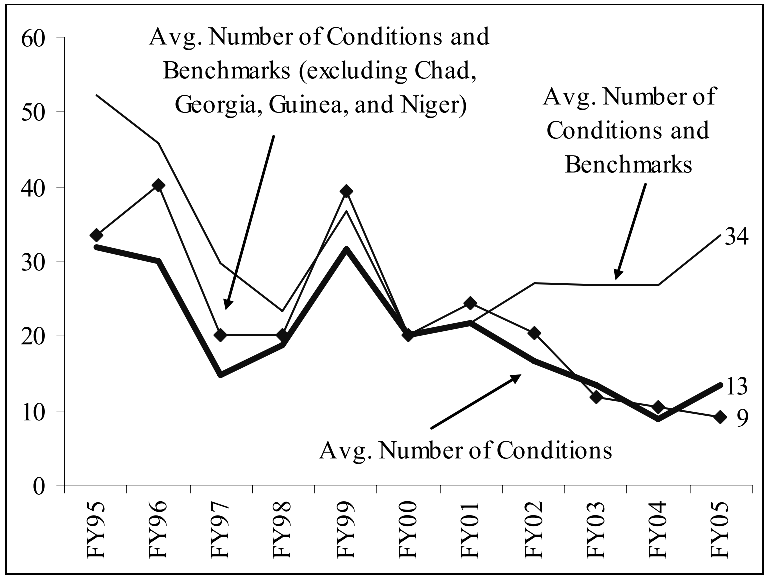
- ***Benchmark growth is country specific***. Of the 18 LICUS countries with policy-based lending during FY00-05, 6 used benchmarks, and in 4 of these (Chad, Georgia, Guinea, and Niger), the number was very high. In the case of Chad, for example, loans typically contained above 40 benchmarks, while loans to Georgia and Niger contained between 15-20 benchmarks. In general, loans to these four countries account for most, if not all, of the benchmarks in LICUS countries (see Figure 87).

Figure 86. Trends in the Number of LICUS Loans, by Tranche



Source: ALCID, World Bank.

Figure 87. Trends in Conditions in LICUS Countries, FY95-05
(excluding Chad, Georgia, Guinea, and Niger)



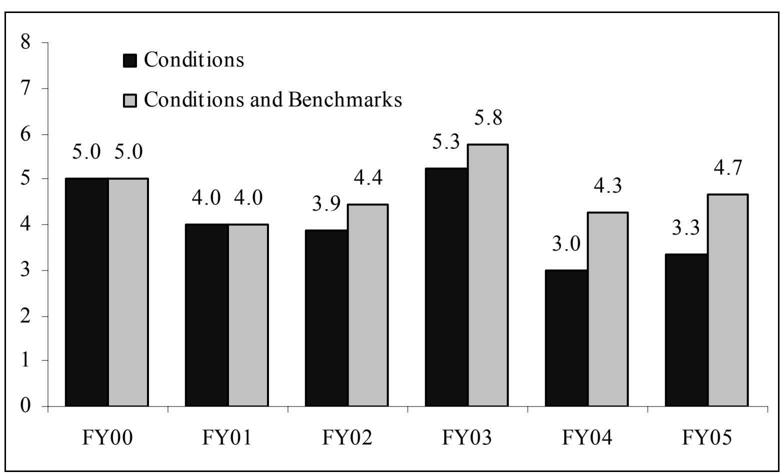
Source: ALCID, World Bank.

C. Thematic Coverage

112. Conditions are increasingly focused on a few areas. On average, FY05 loans focused on three areas, compared to around five in FY00 loans and during the previous five fiscal years on average (see Figure 88). However, coverage is broader when taking into account benchmarks. Six of the 24 loans approved during FY00-05 had benchmarks in areas outside the ones covered by the conditions. If indicative benchmarks remain within the original areas covered by the conditions, loans tend to remain focused on three or four areas and on average there are 18 conditions and benchmarks. Otherwise, there is a tendency for expanding coverage to more than five or six reform areas, with the result that there are more than 50 conditions and benchmarks on average. As noted above, this trend is driven by loans to a very few countries.

113. ***Area Focus.*** The largest concentration of conditions is in public governance areas. All loans to LICUS countries had public expenditure management conditions. On average for the FY00-05 period, around 54 percent of all conditions and 68 percent of benchmarks were in public governance areas, followed by a distant 20 percent in private sector development areas, and 5-6 percent in social sector and economic management

Figure 88. Trends in Number of Themes in LICUS Loans, FY00-05



Source: ALCID, World Bank.

areas, respectively (see Table 9). In FY05, 84 percent of conditions were in public governance and rule of law areas, compared with 30 percent in FY00. More than half the public governance conditions were on public expenditure management, financial management, and procurement. However, there is a growing trend in conditions addressing rule of law and accountability/anticorruption issues, but these actions are mostly described in benchmarks. Conditions in administrative and civil service reform posted the highest growth in any single area, growing, from 3 percent in FY00 to 20 percent of all conditions in FY05. Issues of decentralization do not figure prominently in Bank conditions to LICUS countries (less than 1 percent).

114. ***Fiduciary Conditions.*** Fiduciary conditions vary on a country-by-country basis, but it is possible to identify some common elements across countries that may indicate some minimum level of fiduciary controls in a fragile environment.

- ***Procurement.*** Conditionality covers preparation, submission, and execution of a sound public procurement code, setting forth specific rules and procedures on procurement plans, audit requirements, and penalty rules in case of fraud; and training and information systems.
- ***Budget management.*** Conditionality includes preparation, submission, and execution of single-year budget laws and directives, including reporting mechanisms and allocation/expenditure tracking in priority sectors, and evidence of multiyear budget programming (MTEF).
- ***Monitoring and evaluation.*** Conditionality includes institutional set-up or strengthening of monitoring and evaluation functions and systems with regard to cash management, and public spending in health and education.
- ***Disclosure.*** Conditionality includes wide publication and dissemination (in reports or websites) of procurement and of budget (allocation and execution) data on a regular basis.

115. ***Declining Sectors.*** Conditions in the social sectors and financial/PSD areas have been declining in recent years to around 4 percent each in FY05 from around 21-26 percent each in FY00. The largest decline in the social sectors is coming from health and education subsectors and in the financial/PSD area from privatization and regulation/competition policy. Some 40 percent of loans approved during FY00-05 had social sector conditions and 80 percent had financial/PSD related conditions.

116. ***Macroeconomic Conditions.*** On average, one in 10 conditions relate to macroeconomic management, and half of those just spell out the need to maintain an adequate macroeconomic environment while the other half addresses debt reduction and arrears clearance issues. Only half of the loans approved during FY00-05 had specific macro management conditions.

Table 9. Trends in the Share of Conditions and Benchmarks by Themes, FY00-05 1/

	FY00	FY01	FY02	FY03	FY04	FY05 1/	Avg. FY00-05
Number of Loans	**4**	**3**	**7**	**4**	**3**	**3**	**4**
Conditions - Number of Conditions	**80**	**65**	**117**	**54**	**33**	**51**	**67**
in shares of Conditions (%)							
Trade and Economic Management	13.8	1.5	4.3	7.4	21.2	3.9	8.7
Environment, Rural and Urban Development	8.8	6.2	6.0	7.4	0.0	3.9	5.4
Social Sectors	26.3	7.7	8.5	14.8	3.0	3.9	10.7
Financial and Private Sector Development	21.3	29.2	26.5	16.7	24.2	3.9	20.3
Public Sector Governance and Rule of Law	30.0	55.4	54.7	53.7	51.5	84.3	54.9
of which:							
Public expenditure, financial management and procurement	10.0	23.1	35.9	38.9	27.3	43.1	29.7
Administrative and civil service reform	2.5	7.7	3.4	3.7	15.2	19.6	8.7
Tax policy and administration	5.0	13.8	1.7	0.0	0.0	3.9	4.1
Decentralization	0.0	0.0	1.7	1.9	0.0	2.0	0.9
Rule of Law	0.0	0.0	1.7	1.9	0.0	5.9	1.6
Other public sector governance, accountability/anti-corruptio	12.5	10.8	10.3	7.4	9.1	9.8	10.0
Other accountability/anti-corruption	6.3	0.0	0.9	1.9	3.0	2.0	2.3
Other public sector governance	6.3	10.8	9.4	5.6	6.1	7.8	7.6
	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Benchmarks - Number of Benchmarks			**73**	**53**	**72**	**56**	**64**
in shares of Milestones Conditions (%)							
Trade and Economic Management	-	-	0.0	0.0	6.9	1.8	2.2
Environment, Rural and Urban Development	-	-	5.5	17.0	0.0	12.5	8.7
Social Sectors	-	-	11.0	9.4	11.1	3.6	8.8
Financial and Private Sector Development	-	-	12.3	15.1	9.7	8.9	11.5
Public Sector Governance and Rule of Law	-	-	71.2	58.5	72.2	73.2	68.8
of which:							
Public expenditure, financial management and procurement	-	-	52.1	43.4	50.0	33.9	44.8
Administrative and civil service reform	-	-	15.1	11.3	2.8	10.7	10.0
Tax policy and administration	-	-	0.0	1.9	1.4	0.0	0.8
Decentralization	-	-	0.0	0.0	2.8	1.8	1.1
Rule of Law	-	-	0.0	1.9	5.6	5.4	3.2
Other public sector governance, accountability/anti-corruptio	-	-	4.1	0.0	9.7	21.4	8.8
	-	-	100.0	100.0	100.0	100.0	100.0
Conditions and Benchmarks - Number	**80**	**65**	**190**	**107**	**105**	**107**	**109**
in shares of Binding and Non-Binding Conditions (%)							
Trade and Economic Management	13.8	1.5	2.6	3.7	10.5	2.8	5.8
Environment, Rural and Urban Development	8.8	6.2	5.8	12.1	0.0	8.4	6.9
Social Sectors	26.3	7.7	9.5	12.1	9.5	3.7	11.5
Financial and Private Sector Development	21.3	29.2	21.1	15.9	14.3	6.5	18.0
Public Sector Governance and Rule of Law	30.0	55.4	61.1	56.1	65.7	78.5	57.8
of which:							
Public expenditure, financial management and procurement	10.0	23.1	42.1	41.1	42.9	38.3	32.9
Administrative and civil service reform	2.5	7.7	7.9	7.5	6.7	15.0	7.9
Tax policy and administration	5.0	13.8	1.1	0.9	1.0	1.9	3.9
Decentralization	0.0	0.0	1.1	0.9	1.9	1.9	1.0
Rule of Law	0.0	0.0	1.1	1.9	3.8	5.6	2.1
Other public sector governance, accountability/anti-corruptio	12.5	10.8	7.9	3.7	9.5	15.9	10.1
	100.0	100.0	100.0	100.0	100.0	100.0	100.0

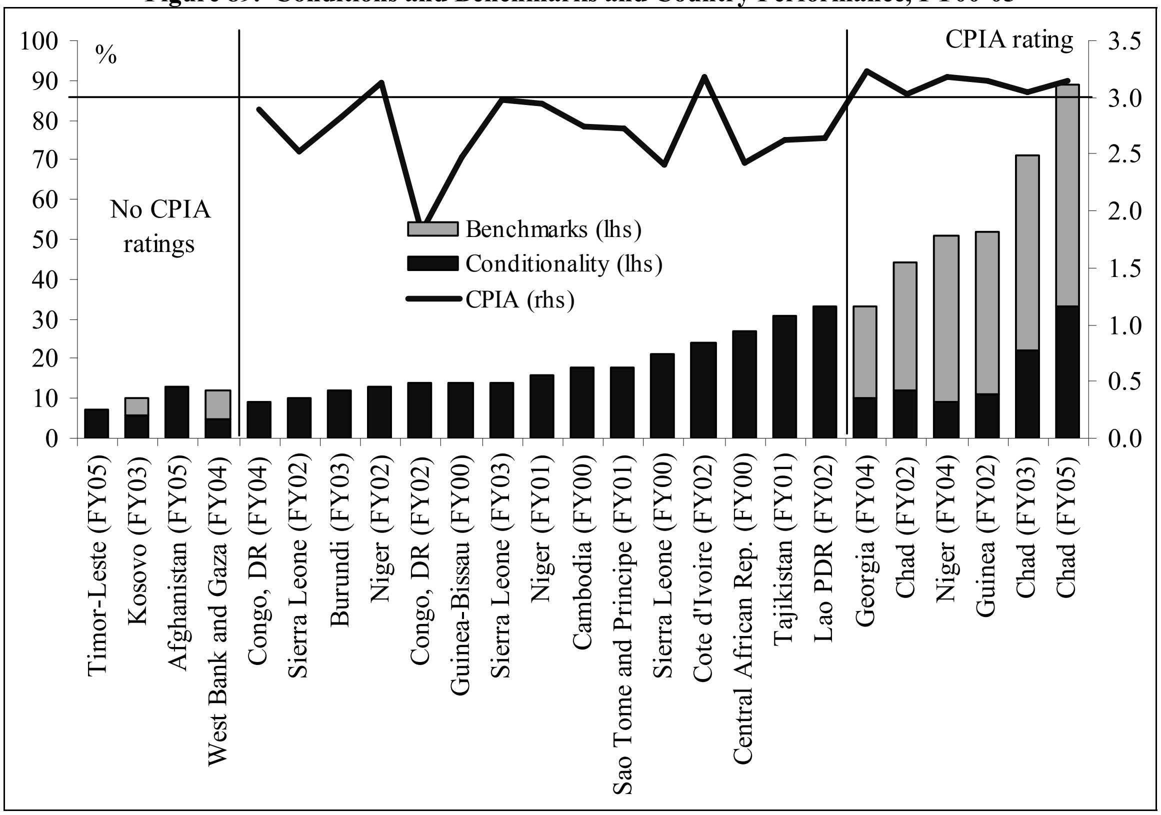
1/ FY05 data is for three loans approved as of March 31, 2005. There are three other loans to be approved in Q4.

Source: ALCID, World Bank.

D. Selectivity

117. Most LICUS countries have a CPIA rating of around 3.0 or below, representing the bottom bracket of the performance scales for countries receiving IDA funds. To better understand conditions trends in relation to performance ratings, countries were assigned to one of three groups: (a) LICUS countries with no CPIA ratings; (b) LICUS countries with CPIA rating below 3.0; and (c) LICUS countries with ratings of 3.0 or above (see Figure 89). The analysis shows that the content of conditions deepens with country performance, indicating that the Bank tailors its assistance to the country's track record, implementation capacity, and state of fiduciary arrangements. Below is a description of conditions supported in each of these three groups.

Figure 89. Conditions and Benchmarks and Country Performance, FY00-05



Source: ALCID, World Bank.

- ***No CPIA ratings***. In a select few cases, the Bank has extended grant financing to countries that lacked a CPIA rating (Afghanistan, Kosovo, Timor-Leste, and West Bank and Gaza). Conditions in these few cases are often focused on a small number of priority actions (less than 10 conditions in no more than two to three areas) drawn from a larger government/donor program matrix. For instance, in Afghanistan, conditions focused entirely on public sector governance, particularly on tax reform and on the adoption of procurement and budget laws and regulations. In Kosovo, conditions focused on building private sector institutions (property rights) and on establishing the legal framework for public financial management, procurement, tax administration, and budget formulation, execution, and auditing. In West Bank and Gaza, conditions also focused on basic public sector governance measures (passage of a budget law), on public sector hiring targets, and on initial valuation of operational and financial assets of the authorities. There were some benchmarks mostly linked to social spending monitoring and setting the institutional responsibilities for auditing, financial management, and procurement. In order to better differentiate the groups, we will call conditions in this group "basic" post-conflict conditions.

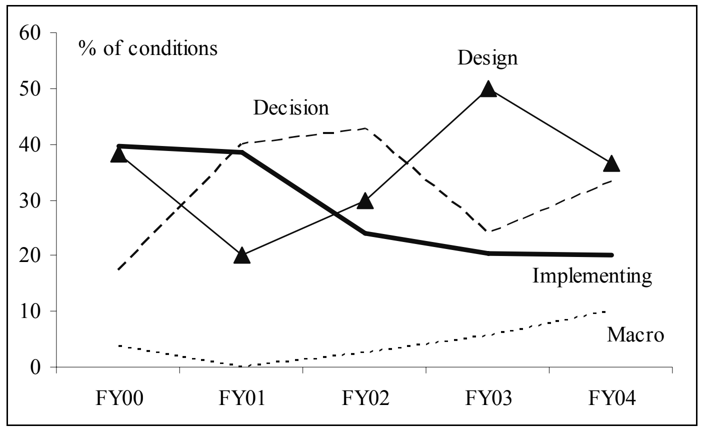
- ***CPIA Rating below 3.0***. The majority of LICUS countries—9 of 16—have a CPIA rating below 3.0 (the average is 2.6). Loans to these countries cover a wider range of areas in addition to those discussed above in the "basic" group. The prevalent environment is one of initial, broader scale donor engagement. On average for FY00-05, there were around 18 conditions in these loans (between 9-30 conditions) and there were on average 4.5 thematic areas covered (between three to seven areas). For example, on financial and PSD areas, the Bank begins to support the regulatory framework and some privatizations of selected agricultural sectors and state-owned enterprises (e.g., telecom), banking regulation, and the improvement of the business environment. On the public sector governance side, conditions often focused on carrying out and implementing recommendations of core Bank products (public expenditure reviews, CFAAs, CPARs), the preparation and submission to parliament of budgets, budget directives, and procedural codes on financial management and procurement, and the setting up of medium-term expenditure frameworks. In some countries, conditions went further, into administrative and civil service reforms and the development of integrated financial management systems. Social sector conditions went as far as creating special funds and eligibility requirements to address reinsertion and reintegration of displaced persons and other victims of conflict.

- ***Rating of 3.0 or above (marginal LICUS).*** This is a small group of four or five LICUS countries where the engagement is somewhat mature and where the agenda is deeper and implementation more complex. The Bank's engagement in these countries depends solely on country performance and track record—the average CPIA rating is 3.1. In addition to the reforms describe in the above two country groups, conditions in this group of countries begin to address more complex set of issues. For example, on the PSD side, conditions begin to address private participation in infrastructure in addition to the elaboration of more comprehensive public enterprise reform strategies (privatization scenarios), microfinance schemes and competition policies, banking consolidation, and the elaboration of customs reform strategies. On the social sectors side, conditions begin to show some medium-term engagement with the adoption of 5-10 year health and education sector development plans and the preparation of sector-specific public expenditure reviews, which begin to lay out the monitoring and evaluation benchmarks on which to judge future sector performance. In one case, the Bank supported short-term outcome conditions in the adoption of measures to increase internal efficiency in education and to limit repetition rates. PSIAs and beneficiary incidence analysis are done also at this stage, including greater disclosure of general and sector-specific budget and financial data (cash management). Conditions also support the operationalization of procurement codes, training in public procurement management, introduction of performance-based evaluation systems in procurement, and the development of national governance strategies and the creation of anticorruption oversight committees. Audits of large procurement contracts begin to take place as well as the completion of public expenditure tracking surveys. Rule of law conditions also emerged at this stage, with basic judicial reforms addressing the disclosure of court decisions, training of judges, and general measures to modernize the judicial system.

E. Types of Conditions

118. The decline in conditions also had an impact on the types of conditions. On average, process, decision, and implementation conditions each account for about one-third of conditions in FY00-04 LICUS loans. In FY04, LICUS loans had on average three conditions in each of the three types. However, trends show that the relative importance of implementation conditions has been declining in recent years, falling from 40 percent of conditions in FY00 to 20 percent by FY04 (see Figure 90), with design or process conditions taking most of the lost space—indicating that the decline in conditions may have had an impact in rationalizing the use of implementing conditions and instead encouraged the use of process conditions. Decision type conditions have remained stable in recent years and there has been some growth in the importance of macro type conditions.

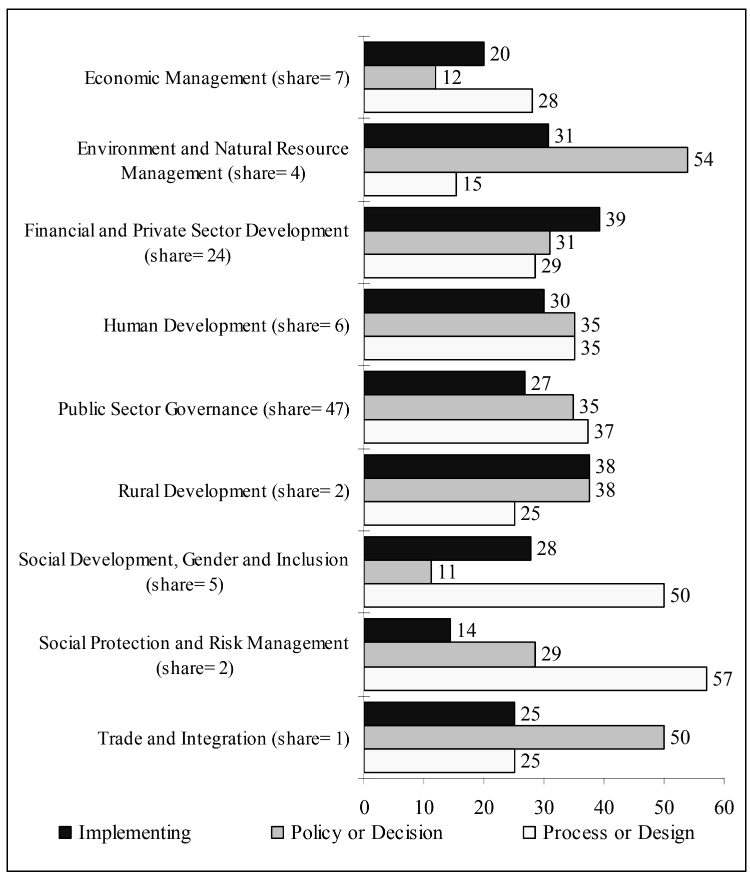
Figure 90. Trends in Types of Conditions, FY95-05



Source: ALCID, World Bank.

119. ***Public Sector Governance.*** Public sector governance actions account for about half of total conditions and are the leading group of conditions in each of the three major types of conditions: design or process type conditions (37 percent), decision type conditions (35 percent), and, to a lesser extent, implementing type conditions (27 percent) (see Figure 91). The greater the number of public expenditure management, financial management, and procurement conditions, the higher the likelihood that they will be design conditions (see Figure 92).

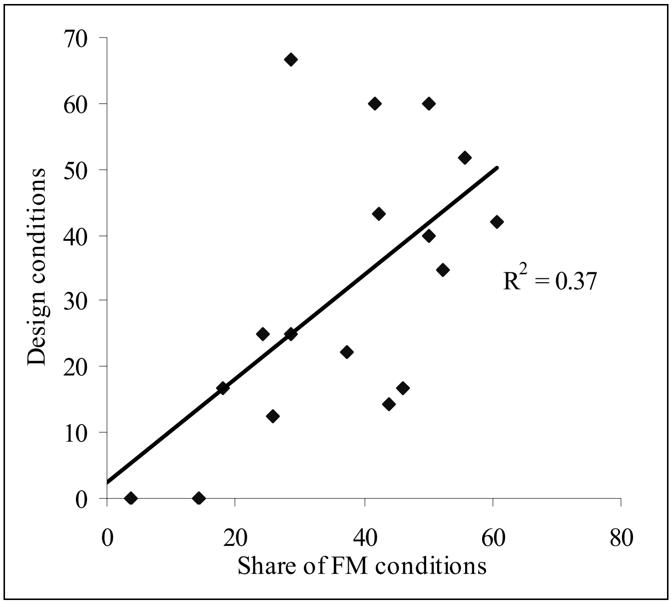
Figure 91. Types of Conditions by Thematic Areas, FY00-04



Source: ALCID, World Bank.

120. ***Financial and PSD Conditions.*** Financial and private sector development is the next largest thematic group of conditions (24 percent) and it is also the reform area with the highest concentration of implementing type conditions (39 percent). Decision and design each account for about 30 percent of financial and PSD conditions.

Figure 92. Share of Financial Management Conditions and Design Type Conditions, FY00-04 (25 loans)



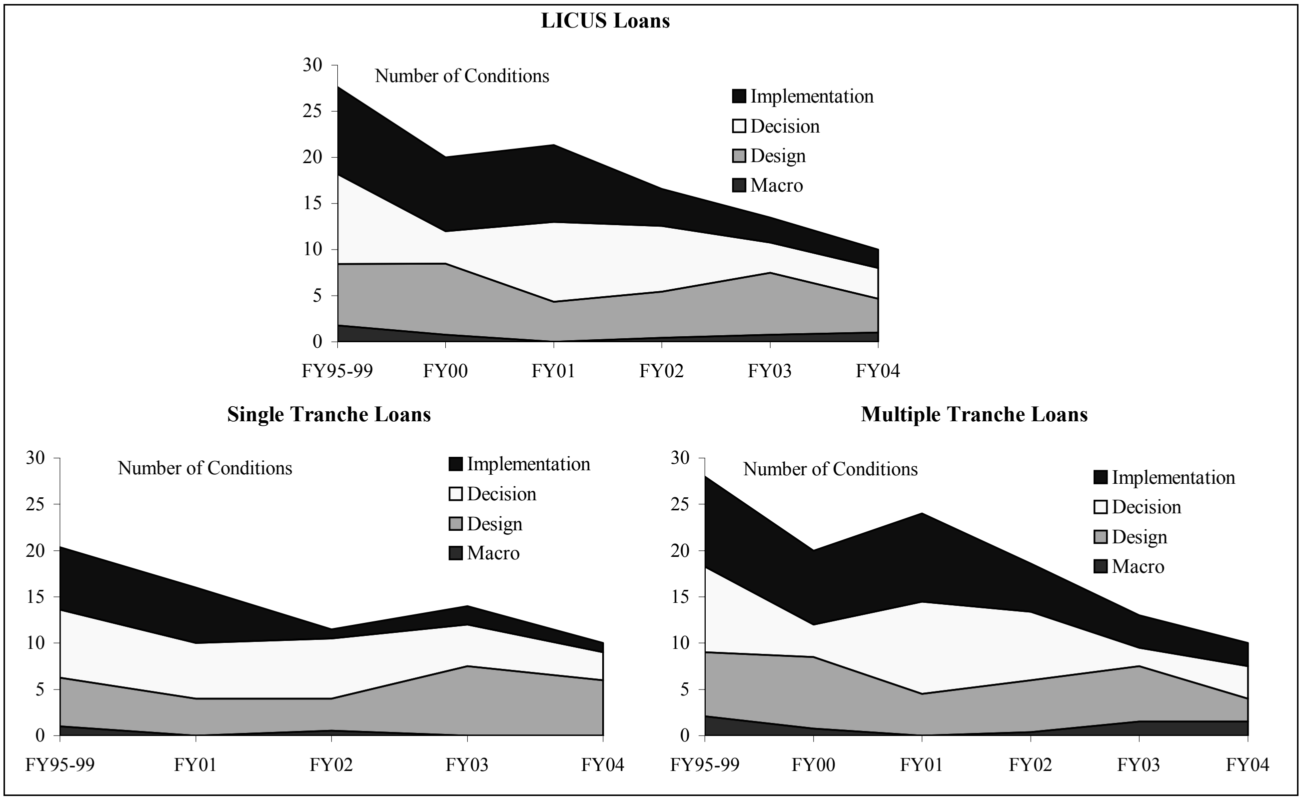
Source: ALCID, World Bank.

121. ***Social Sector Conditions.*** Around 44 percent of LICUS conditions in the social sectors relate to design, a much larger share than in public sector governance conditions and financial/PSD areas. Decision and implementing type conditions account for the other 56 percent (broadly equally divided).

122. ***Implementation Conditions.*** With the decline of conditions, implementation conditions have virtually disappeared from single-tranche loans in LICUS. On average for FY04 LICUS loans, only 1 out 10 conditions related to implementation (or around 10 percent of all conditions), compared with 6-7 conditions in the late 1990s out of 16-20 conditions (or around 35 percent of all conditions) (see Figure 93). Conversely, design type conditions have increased rapidly in single-tranche loans, from around 4 conditions on average during the second half of the 1990s (or around 25 percent of all conditions) to around 6 conditions in FY04 (or around 60 percent of all conditions). In the case of multitranche loans, the relative proportion of implementing conditions also declined but less sharply, from around 40 percent in FY00 to around 25 percent in FY04, while design conditions fell during this short period, from 38 percent of conditions in FY00 to around 25 percent of conditions in FY04. Most conditions in multitranche loans are decision types.

123. ***Performance Factor.*** Implementation conditions are more important in lower performing LICUS countries. On average for LICUS countries with CPIA ratings below 3.0, around 31 percent of conditions are implementation types, compared with 17 percent in LICUS countries with CPIA ratings above 3.0. While the share of design conditions appears to be the same across country performance (around 35 percent), when factoring in benchmarks the share of design conditions in higher performing LICUS countries is above 40 percent. In the case of Kosovo, where the environment and country capacity did not allow for substantive implementing conditions, most conditions were decision types (67 percent) and the rest were design types.

Figure 93. Trends in Number of Conditions, by Types and by Tranche, FY95-04



Source: ALCID, World Bank.

124. ***Outcome Conditions.*** There was limited use of outcome type conditions in loans to LICUS countries. Two examples of outcome type conditions are the disarming of 11,000 ex-combatants, and reducing the number of procuring entities from 8,000 to 3,000 while introducing permanent procurement units as part of the structure within each procuring entity.

VIII. AGGREGATE CONDITIONALITY: BANK-FUND CONDITIONALITY

Overview

125. The World Bank and the IMF historically have complementary roles that evolved over time: the Bank supports developing and transition countries with long-term lending and policy advice to promote economic growth and reduce poverty, and the Fund provides short-term funding to members that face balance of payments difficulties. In practice, the Bank and the Fund have overlapping mandates and have long understood the need to work in close collaboration while defining their respective roles.

126. ***Consequences of Collaboration.*** Over the past years, both institutions have undertaken significant efforts aimed at streamlining conditionality and strengthening collaboration at the country level. Following these initiatives, two key questions arise: (a) has the burden of conditionality lightened for borrowing countries; and (b) have coverage gaps arisen with the streamlining of conditionality by both institutions? Among the main findings of this section are the following:

- This and other recent reviews of Bank-Fund collaboration suggest an overall reduction of critical conditions, although to a lesser extent in low-income countries.

- The coverage of conditionality is driven by the development priorities of borrowing countries. In the context of collaboration, the Fund and the Bank engage with borrowing countries in a variety of ways, all of which may fill the presumed "gap" (for example, continuing the policy dialogue, technical assistance, analytic work, and so forth).

- The following challenges remain: interpretation of the lead agency concept and criticality in practice; institutional differences between the Fund and the Bank; and streamlining of conditionality in the broader context of donor harmonization.

A. Principles Guiding Bank-Fund Collaboration

127. In March 1989, the Boards of the two institutions approved an agreement, the so-called "Concordat," on collaboration and cooperation. It was agreed that in the context of their cooperation, each organization would concentrate on its area of comparative advantage: the IMF is responsible for the dialogue with country authorities on macroeconomic and related structural issues, while the Bank takes the lead in providing assistance on social, infrastructure, and structural issues. According to the Concordat:

- The Fund's principal objectives are the promotion of economic conditions conducive to growth, price stability, and balance of payments sustainability.

- The Bank's objectives were listed as promoting economic growth and conditions conducive to efficient allocation of resources. In pursuing these objectives, the Bank focuses on "development strategies; sector and project investments; structural adjustment programs; policies that deal with the efficient allocation of resources in both public and private sectors; priorities in government expenditures; reforms of administrative systems, production, trade, and financial sectors; the restructuring of state enterprises and sector policies,"[11] and issues relating to the creditworthiness of its members.

- While focusing on their respective areas of primary responsibility, staff in each institution need to be sufficiently informed of all key factors that have an important bearing on decisions made by their institutions in the pursuit of their respective objectives and mandates. However, "…in the interest of efficiency of staff resource use, each institution should rely as much as possible on analyses and monitoring of the other institution in the areas of primary responsibilities of the latter, while safeguarding the independence of institutional decisions."[12]

128. ***Recent Agreements.*** All subsequent reviews and documents on Bank-Fund collaboration have affirmed the principles set out in the Concordat. The "Report of the Managing Director and the President on Bank-Fund Collaboration" (1998) clarified responsibilities in new areas of overlap and recommended early and frequent consultations between staffs of the two institutions in order to promote effective coordination, particularly "…in cases where the country's program supported by one institution includes macroeconomic and structural measures which fall within the other institution's areas of primary responsibility."[13] The paper also stated: "Each institution retains separate accountability for its lending decisions."[14] In August 2001, the Boards and Managements of the Bank and Fund agreed to strengthen collaboration on country programs and conditionality.[15] The strategy, reviewed in August 2002 and February 2004,[16] involves upstream collaboration, clear delineation of responsibilities by designating the lead agency, and transparent reporting of each institution's views in Board documents. Under the agreement, each institution remains ultimately accountable for its own lending decisions and for safeguarding its resources.

B. Trends in Aggregate Conditionality

129. Trends in aggregate Bank-Fund conditionality are difficult to track because of the difference in instruments and methodological factors. To examine the effect of streamlining on conditionality by both institutions, a sample of countries was selected that had parallel Bank- and Fund-supported programs, i.e. a program approved at each institution within 12 months of each other before end-2000 (referred to as the "before" period) and within 12 months of each other since early 2001 (referred to as the "after" period). A total of 30 countries—18 low-income and 12 middle-income countries—matched these criteria. The individual conditions of the Fund- and Bank-supported programs were compared, using the following sector classification categories: tax policy and administration, expenditure management and control, governance, financial sector reform, public enterprise reform (including privatization), civil service reform, social sector policies (including poverty monitoring), macroeconomic management, productive sectors and

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[11] See *Bank-Fund Collaboration in Assisting Member Countries* (SM/89/54), March 30, 1989.

[12] See *Bank-Fund Collaboration in Assisting Member Countries* (SM/89/54), March 30, 1989.

[13] See *Report of the Managing Director and the President on Bank-Fund Collaboration* (SecM98-733), September 4, 1998.

[14] See *Report of the Managing Director and the President on Bank-Fund Collaboration* (SecM98-733), September 4, 1998.

[15] See *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality* (SecM2001-0461), August 23, 2001.

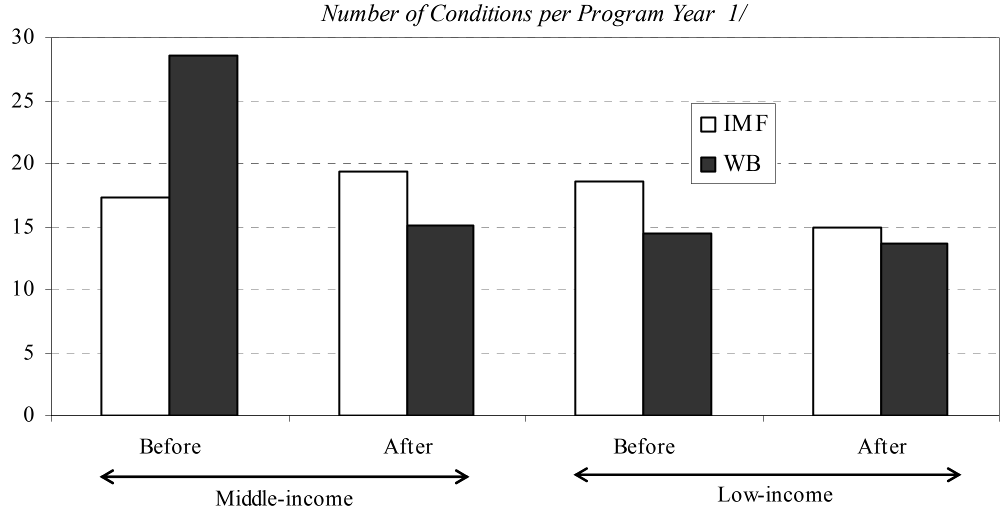
[16] See *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality – Progress Report* (SecM2002-443), August 19, 2002; and *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality–Progress Report* (SecM2004-0070), February 24, 2004.

business environment. The results should be interpreted with caution because of the relatively small size of the sample. The analysis also draws, where relevant, on the findings of other reviews, including country case studies undertaken by the Fund and the Bank.

130. ***Critical Conditions.*** The number of aggregate critical program conditions has decreased. The sample data suggest an overall reduction in aggregate critical conditions, including by 14 percent for low-income countries and by 25 percent for middle-income countries (see Figure 94). An almost 50 percent decline in the number of Bank conditions per program year is driving an overall decline of aggregate conditionality in middle-income countries. Both institutions have decreased their conditionality in low-income countries as a result of their collaboration in supporting the poverty reduction strategy process. These results are consistent with a country-specific analysis of low-income countries undertaken jointly by the Independent Evaluation Office (IEO) of the Fund and the Operations Evaluation Department (OED) of the Bank.[17]

Figure 94. Aggregate Bank-Fund Conditionality (showing Bank critical conditions)

Number of Conditions per Program Year 1/



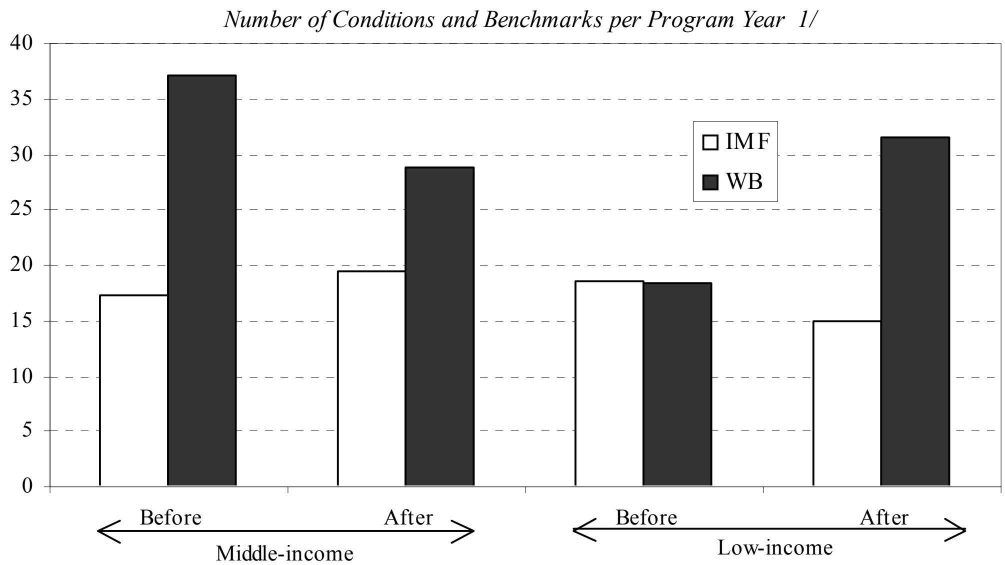
1/ "Before" refers to programs until late 2000; all other programs are classified as "after" programs.
Source: MONA (IMF) and ALCID (World Bank) database.

131. ***Indicative Benchmarks.*** As seen earlier in the report, there is a significant increase in the number of indicative benchmarks in the Bank-supported operations in low-income countries. Conditionality consists of critical program conditions that must be met for the disbursement of a development policy operation; it typically covers only a subset of the Bank's engagement with borrowing countries. The Bank's support for a country's policy program through analytic work, technical assistance, and general policy dialogue covers a broader range of areas and issues. The Bank-supported program is typically reflected in a set of indicative benchmarks that are embedded in the country's overall development program and are used for the implementation of the program and assessment of progress. While the Bank has reduced the number of critical conditions in Bank-supported programs, it has maintained a broad-based policy dialogue across

[17] The review finds an average of about one-third reduction in the number of total Bank-Fund conditions across the selected low-income countries, while ranging from an almost 50 percent in Albania to 6 percent in Tanzania. This was almost entirely due to a reduction in Bank conditionality. See *Evaluation of the IMF's Role in Poverty Reduction Strategy Papers and the Poverty Reduction and Growth Facility* (IMF 2004), July 6, 2004.

different sectors, which is reflected in an increased number of benchmarks in the policy matrices. Accounting for both conditions and benchmarks in the Bank-supported operations shows an increase on average by 25 percent in low-income countries and a decrease by 11 percent in middle-income countries (see Figure 95). The increase in low-income countries can be attributed to the multisectoral nature of PRSCs for which a large number of benchmarks are characteristic.

Figure 95. Aggregate Bank-Fund Conditionality (showing Bank conditions and benchmarks)



1/ "Before" refers to programs until late 2000; all other programs are classified as "after" programs.
Source: MONA (IMF) and ALCID (World Bank) database.

132. ***Collaboration in Low-Income Countries.*** Building on the PRSP approach, much progress has been achieved in low-income countries with respect to aggregate Bank-Fund conditionality and the division of labor between the two institutions. Better upstream engagement between staff of the two institutions remains key to strengthening collaboration and improving consistency of support and conditionality in the borrowing countries. In low-income countries, the country-owned PRSP process serves as an appropriate platform for such upstream engagement, as it typically includes multiple consultations among the country government, civil society, and donor community. The joint staff advisory notes of PRSPs and PRSP progress reports provide a means for Bank and Fund country teams to ensure that the full range of needed policy advice is made available to the countries.

133. In low-income countries, both institutions have tended to focus their conditionality on their core areas of responsibility (see Figure 96). The sector coverage of conditions and benchmarks is useful to examine the trends in division of labor between the institutions over time. A number of trends emerge, which are supported by other reviews of aggregate conditionality and individual country case studies (see Box 1):

- During the "before" period, both institutions were equally present in the areas of expenditure management and control, financial sector reform, public enterprise reform, governance, and civil service reform.

- Over time, the Fund has increased its conditionality in the financial sector reform and kept the lead agency's role in the areas of tax policy and administration and macroeconomic management.

- The Bank, in turn, has increased its conditionality in governance and public enterprise reform and kept the lead agency's role in providing assistance on social sector policies and the productive sectors and business environment.

- Both institutions have expanded conditionality in the areas of expenditure management and control and civil service reform, as both see these as critical for their work. However, in terms of the number of conditions per program year, the Bank has taken the lead in the areas of expenditure management and control, governance, and public enterprise reform.

- When accounting for conditions and benchmarks, the Bank has been involved in all sectors, except macroeconomic management and financial sector reform.

Figure 96. Sector Classification of Conditionality in Low-Income Countries
(number of conditions normalized per program year)

Figure VIII.3A. Accounting for critical conditions in the Bank-supported programs

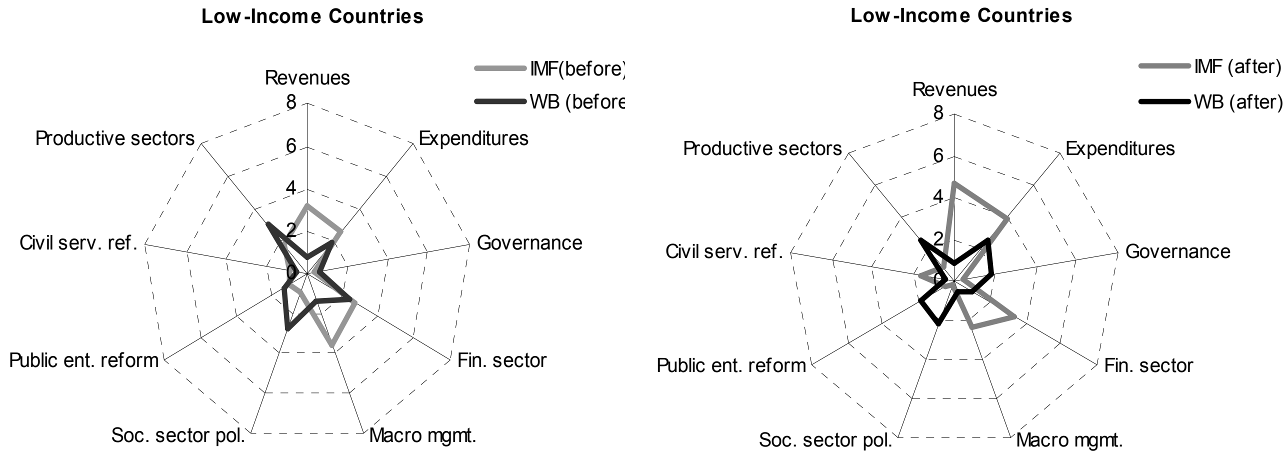
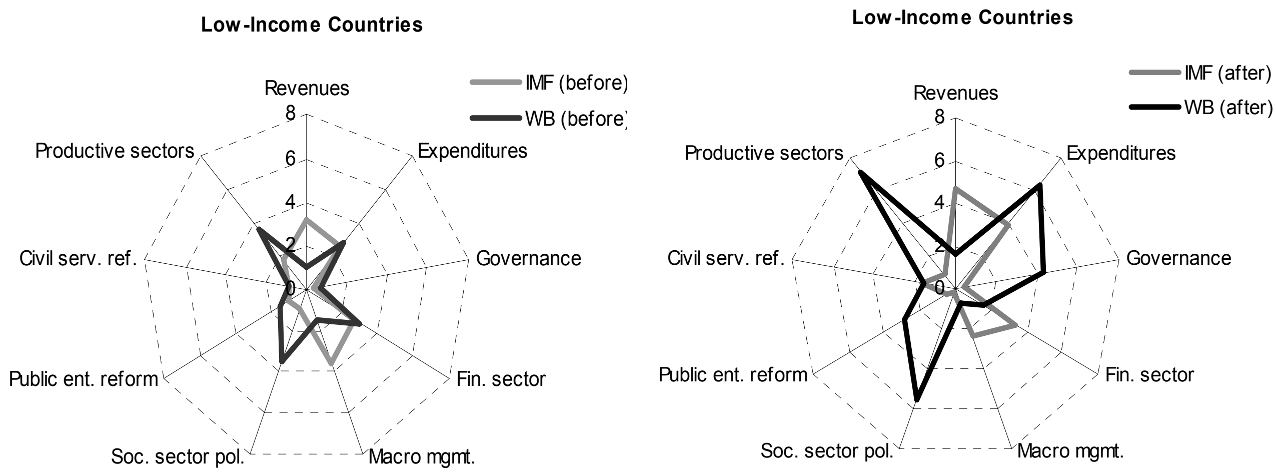


Figure VIII.3B. Accounting for critical conditions and benchmarks in the Bank-supported programs



Source: MONA (IMF) and ALCID (World Bank) database.

Box 1. Aggregate Conditionality in PRSP Countries

Analyzing the changes in structural conditionality in 10 PRSP countries, the case studies confirm that the streamlining efforts of the two institutions resulted in an overall decrease of aggregate conditionality, as well as a shift in its composition, with each institution focusing more on the areas of its respective responsibility. For instance, the 1998 Nicaragua ESAF contained a number of structural benchmarks in the areas of governance and legal reform. Since this is an area where the World Bank has greater expertise, IMF-supported programs in Nicaragua initially relied on the Bank's advice to include these conditions in the program. More recently, however, the IMF no longer includes direct governance-related conditions in the context of program activities. In Tanzania, Bank-supported programs have moved out of tax reform and the financial sector, and Fund-supported programs have moved out of the social sectors and civil service reform.

The case studies also suggest that streamlining conditionality poses a greater challenge, especially when the objectives and priorities of the Fund and the Bank in areas of overlapping interest are not identical. The establishment of conditionality on state-owned enterprise (SOE) reform in Vietnam provides a good illustration. There was a noticeable shift in the division labor between the Bank and the Fund on SOE from the first to the second year of the PRGF and from PRSC I to PRSC II. Accepting the streamlining approach, the Fund staff concentrated on the broad fiscal aspects of policies, leaving detailed SOE targets (at the firm level) to be monitored by the Bank. The Fund's main concern in the SOE area was to address the macroeconomic vulnerabilities represented by the largest and most fiscally significant SOE. The Bank's primary interest, on the other hand, was private sector development and the demonstration effect of privatizing even small SOEs, a position that was consistent with the government's own priorities. In this context, the conditionality negotiated under the PRSC did not fully address the Fund's concerns.

Source: *Summaries of Ten Country Case Studies Undertaken as Part of the IEO Evaluation of the PRSP/PRGF and OED Review of the Poverty Reduction Strategy (PRS) Process* (CODE2004-0052), July 6, 2004.

134. ***Collaboration in Middle-Income Countries.*** There is no single formal framework for Bank-Fund collaboration in middle-income countries, which represent a diverse set and pose a variety of challenges. At one end of the range, there are investment grade middle-income countries that have access to international financial markets and borrow infrequently from either the Bank or the Fund. Nevertheless, these countries may request assistance to strengthen social and sector-specific policies and institutions on occasion or at the time of crisis. On the other hand, there are middle-income countries with weak institutions and limited capacity, which require a similar kind of support and approach as low-income countries, particularly in strengthening governance and focusing on medium-term development outcomes. In addition, middle-income countries accessing the European Union receive significant financial assistance from the European Union and other donors, and thus require the Bank and the Fund to coordinate their activities in a broader framework.

Figure 97. Sector Classification of Conditionality in Middle-Income Countries
(number of conditions normalized per program year)

Figure VIII.4A. Accounting for critical conditions in the Bank-supported programs

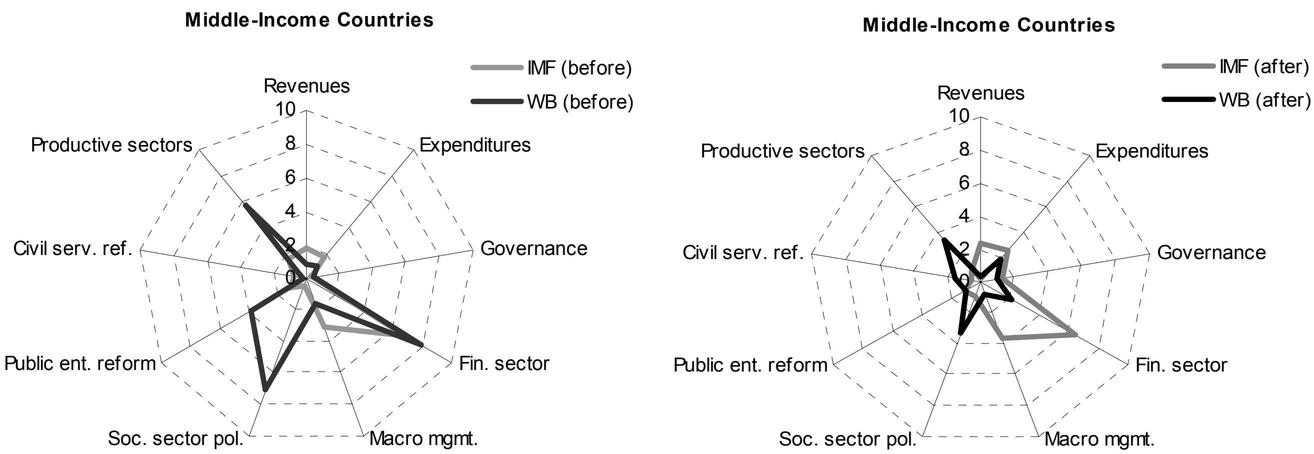
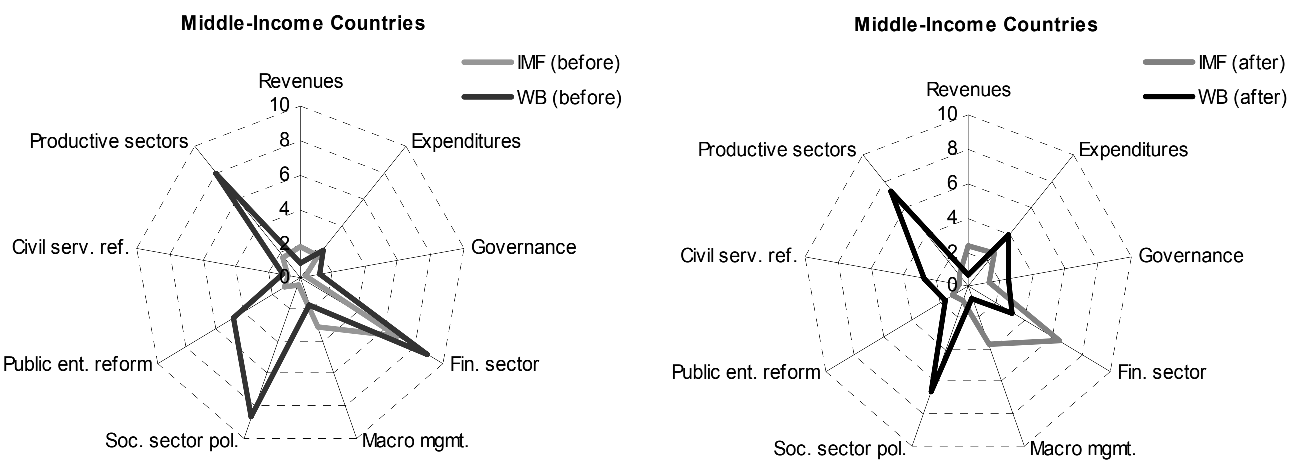


Figure VIII.4B. Accounting for critical conditions and benchmarks in the Bank-supported programs



Source: MONA (IMF) and ALCID (World Bank) database.

135. ***Core Area Focus.*** Overall, both the Bank and the Fund have maintained their focus on respective core areas of responsibility in middle-income countries (see Figure 97). During the "before" period, both the Fund and the Bank significantly overlapped in the areas of expenditure management and control and financial sector reform. The Fund took the lead in the areas of tax policy and administration and macroeconomic management, and the Bank led the policy dialogue in the areas of governance, social sector policies, public enterprise reform, and productive sectors and business environment. The Bank has further reduced its conditionality in the areas of tax policy and administration and macroeconomic management, while keeping the lead agency's role in the Bank's core areas. The following shifts have been characteristic for the shared areas of

responsibility in the "after" period: the Bank has significantly reduced its conditionality in the area of financial sector reform; and both institutions have increased conditionality in the areas of governance and expenditure management and control.

C. Collaboration on Thematic Issues

136. In overlapping areas of responsibility, pragmatic collaboration across institutional boundaries is practiced. When there is no clear boundary between the roles of the two institutions a sharp division of responsibilities may not work well and the most practical way of approaching these shared areas may be on a case-by-case basis. Coordination with bilateral donors and regional development banks is also often important.

137. ***Financial Sector.*** Both institutions share a strong mandate in the financial sector and fiscal management. Financial sector conditionality is a larger share in the Fund's total conditionality than in the Bank's for both low-income and middle-income countries, and the Bank has decreased its conditionality in this area. The greater focus on the financial sector in the "before" period could be explained by the scale of the financial crises in a number of middle-income countries at that time.[18] A recent OED review (see Box 2) identified weaknesses in Bank-Fund collaboration during the crisis, emphasizing the importance of reaching an agreement on basic approaches and the respective roles of each institution from the outset of crisis. Since 1999, the Bank and the Fund have been collaborating on the Financial Sector Assessment Program, diagnosing a country's financial sector strengths and vulnerabilities and assessing observance of international standards and codes through joint missions. Following the experience of the Asian crisis, the Bank and the Fund have reached specific agreements. The Fund is to focus on shorter-term actions to stem the crisis, such as devaluation of currency, government guarantees of financial liabilities, and government intervention in specific institutions. The Bank is to tackle the longer-term reconstruction of the financial system, including bank restructuring and privatization, corporate restructuring, and improving the legal, regulatory, and accounting structures for both banking and corporations.

Box 2. Bank-Fund Collaboration in Crisis

A recent review by the OED finds that the collaboration with the Fund in countries that experienced a crisis was not always smooth, particularly in Indonesia, Mexico, Russia, and Thailand. The absence of a clear division of responsibilities led in some cases to duplication of efforts, confusion, and disagreements between the Bank and the Fund in post-crisis assistance efforts. In Indonesia and Thailand, the division of responsibilities among the Asian Development Bank, the Bank, and the Fund was not entirely clear in the early stages of the crises, or was not always followed. In Indonesia, Bank staff did not have access to confidential data concerning the financial sector obtained by the Fund. In Thailand, the working relationship gradually evolved on the basis of an agreement that the Fund would focus on banks and the World Bank on finance companies.

Source: *OED Review of Bank Assistance for Financial Sector Reform* (OED Website Version), April 28, 2005.

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[18] The amount of the Bank's support to the financial sector in the borrowing countries has varied significantly from year to year. The Bank responded to the Asian crisis in the second half of 1997 by providing exceptionally large amounts of policy-based lending for financial sector reforms. A total of US$7.0 billion was lent to South Korea, US$1.5 billion to Thailand, and US$1 billion to Indonesia during FY98-99. The subsequent crises in Argentina and Russia also resulted in large amounts of financial sector policy-based lending in FY99.

138. ***Fiscal Management.*** The emphasis on fiscal management conditionality has increased in both middle-income and low-income countries. This reflects the emphasis on improving the effectiveness of overall development expenditures. Conditionality in this area typically relates to formulating medium-term expenditure frameworks, aligning the budget with policy priorities, performing internal and external audits, and ensuring oversight by the legislature and other independent bodies. The sample data show an increase of the Fund's and the Bank's conditionality in this area, particularly in low-income countries in the context of PRSP, as both institutions considers it critical for their work. Collaboration in this area can be ensured through joint analytic work, and coordination on the timing and focus of conditions. The joint Bank and Fund recommendations[19] suggest the following principles of collaboration between the two institutions on public expenditure issues: (a) the Fund should be the lead agency on the aggregate aspects of macroeconomic policy and their related instruments, including public sector spending and revenue, and (b) the Bank should be the lead agency on all issues relating to public expenditure composition and efficiency. However, as the reforms in these areas are interlinked, it is not practical to rigidly allocate specific responsibilities to one or the other institution.

D. Consulting and Coordinating with the IMF on Macroeconomic Issues

139. The Bank's operational policy requires staff to make their own independent assessment of the adequacy of a country's macroeconomic policy framework as a necessary prerequisite for development policy lending. Few Bank operations include specific macroeconomic targets in their conditionality, and in all of these cases, the targets are consistent with those included in the Fund arrangements.

140. ***Operational Policy.*** The Bank's policy on coordinating with the Fund on macroeconomic issues in development policy operations is governed by OP 8.60, *Development Policy Lending*, effective as of September 1, 2004. As the OP states, "In preparing development policy operations, the Bank collaborates with the IMF and other international financing institutions and donors, as appropriate, while retaining responsibility for its financing decisions." The policy set out in OP 8.60 is based on the general framework of Bank-Fund collaboration based on distinct accountability of both institutions, and responsibility of each institution to form its own judgment on whether to proceed with lending operations, while being fully informed of the concerns that the other institution might have regarding the country.[20] Following OP 8.60, the Bank undertakes development policy lending in a country only when it has determined that the country macroeconomic policy framework is appropriate. The presence of an appropriate IMF program is usually an important input in this determination. If there is no Fund arrangement, Bank staff ascertain, before making their own assessment, whether the Fund has any major outstanding concerns about the adequacy of the country's macroeconomic policies. Any outstanding issues relevant to the adequacy of the macroeconomic policy framework raised by the IMF are

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[19] See *Bank/Fund Collaboration on Public Expenditure Issues* (SecM2003-77), February 14, 2003.

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

communicated to Executive Directors. Additional requirements apply to special development policy lending.[21]

141. ***Informing the Board.*** The existing framework for Bank-Fund collaboration addresses the Board's concerns of being fully informed on the most recent understanding of the Fund on the macroeconomic policies of the borrowing country. The IMF has an explicit surveillance function and primary responsibility in advising member countries on macroeconomic policies. The IMF views are communicated to the Bank Board in an annex on Bank/Fund relations—the Fund Relations Note—attached to the program document for a development policy operation. The Fund Relations Note (typically Public Information Notice or Chairman's Statement) is provided by the Fund staff for Bank development policy operations or when warranted by significant developments and changes in country circumstances. To ensure that the Bank Board receives an up-to-date assessment of macroeconomic developments, when Bank and Fund staff jointly consider the information provided by the most recent Public Information Notice (PIN) or Chairman's Statement to be insufficiently up-to-date (over six months old) to provide an adequate assessment of current developments or these are not available, the information to the Bank Board would be provided by an IMF assessment letter. In addition, the existing framework also foresees a full upstream discussion of the issues between the respective staff, as well as the presence of Fund staff in Board discussions to respond to the Executive Directors' concerns.

142. ***Operational Practice.*** Bank operational practice has been in line with operational policy requirements.[22] As shown in Table 10, the great majority of operations in FY00-04 were approved for countries that either had or would soon enter into a Fund arrangement. In the remaining 30 operations, Bank staff ascertained that Fund staff had no major concerns about the adequacy of the country's macroeconomic policies, or worked out solutions that specifically addressed those concerns. The latter set of countries generally fall into one of the following three groups:

Table 10. World Bank Development Policy Lending and IMF Arrangements, FY00-04

	Approval year				
	FY00	*FY01*	*FY02*	*FY03*	*FY04*
Number of policy-based operations [a]	23	30	44	45	41
With IMF arrangement in place at approval	20	24	32	38	31
IMF arrangement within two quarters of approval	2	1	2	1	2
Without IMF arrangement	1	5	10	6	8
Number of countries with policy-based operations [b]	20	27	36	33	34
With IMF arrangement in place at approval date	17	22	25	27	25
IMF arrangement within two quarters of first approval date	2	1	2	1	2
Without IMF arrangement	1	4	9	5	7

[a] Number of policy-based operations approved during the period.

[b] Number of countries for which one or more policy-based operations were approved during the period.

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21 For IBRD-eligible countries that are approaching or are in crisis and that have urgent and extraordinary financing needs, the Bank may on an exceptional basis, provide special development policy lending. OP 8.60 specifically requires that a disbursing IMF-supported program be in place. No special development policy operations have yet been approved under the new OP 8.60.

22 This section updates the note of *Adjustment Lending: Bank Policy and Practice in Consulting/ Coordinating with the IMF* (SecM99-798), December 15, 1999.

- ***Countries with an IMF Staff Monitored Program***. There are several instances of the Bank providing policy lending in the absence of a formal IMF program. However, the countries had reached agreement with the IMF staff on a Staff Monitored Program (SMP). Under the SMP, IMF staff analyzed the macroeconomic framework and performance, helped governments to set targets and interim benchmarks, and then monitored progress accordingly. Although SMPs did not involve use of IMF financial resources and were not approved by the Fund's Board, they did involve careful monitoring. The Bank staff worked closely with the IMF and contributed, as appropriate, to the IMF SMP reviews. The examples include three policy-based operations in Jamaica in FY00, FY02, FY03, Cape Verde Structural Adjustment Credit (FY02), Macedonia Public Sector Management Adjustment Credit (FY02), and Slovak Republic Enterprise and Financial Sector Adjustment Loan (FY02).

- ***Countries with no IMF program***. These are primarily middle-income countries that do not borrow from the IMF, but continue regular Article IV consultations, for example, Chile, Mauritius, Mexico (six policy-based operations in FY00-04), Poland, and Russian Federation. In all cases, the Bank collaborated closely with the Fund, and the Fund Relations Note was presented to the Board in the form of a PIN or an assessment letter.[23] Other examples include Bank-supported operations at the subnational level, for instance, four operations in India and one in Mexico. Even though the IMF did not assess the macroeconomic situation of individual states, it nonetheless did provide an assessment of the country's overall macroeconomic stance before Bank-supported operations were presented to the Executive Board. The Bank coordinated closely with the Fund, and in some cases subnational operations were complementary to the work done by the IMF at the national level.

- ***Countries that have outstanding issues with the IMF.*** In some cases, the Bank has decided to proceed with policy-based lending, while acknowledging the outstanding issues the IMF had with the borrowing country. Examples include the Ukraine Second Programmatic Adjustment Loan[24] and Vietnam Third Poverty Reduction and Support Credit[25] approved in FY04. In both instances, the IMF concerns were specifically addressed in the program document and the Executive Directors were fully informed through attached Fund Relations Notes.

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[23] Starting FY04, where the recent PINs or Chairman's Statements were not available, IMF assessment letters were provided to the Board (e.g., for India, Mexico, Ukraine, and Vietnam).

[24] In Ukraine, the authorities were not able to conclude negotiations with the IMF on a standby arrangement because of arrears on VAT refunds and sectoral VAT exemptions. The Bank's PAL program addressed the issue of VAT exemptions, which was linked to one of the second-tranche conditions. The Bank team also picked up the issue of VAT arrears after the government was unable to reach an agreement with the IMF and requested the authorities to develop an action plan, which, once executed, should resolve the problem with the IMF.

[25] In the case of Vietnam, the third review of the IMF Poverty Reduction and Growth Facility (PRGF) was delayed and eventually cancelled because of an impasse between the State Bank of Vietnam and the Fund concerning compliance with the IMF safeguards policy on audit and publication of the State Bank of Vietnam foreign reserves position. The Bank dealt with the risk explicitly, ascertained that adequate fiduciary controls were in place and that the resources were effectively transferred from the central bank to the budget.

E. Issues in Bank-Fund Collaboration

143. Overall, the principles of Bank-Fund collaboration and current institutional arrangements have worked reasonably well. The surveys of the Fund and Bank staff and of the country authorities conducted in late 2003 as part of the internal review of the progress in strengthening Bank-Fund collaboration provide an overall positive assessment with respect to the quality of collaboration and division of labor (see Box 3). At the same time, a number of issues have arisen that deserve closer attention.

Box 3. Assessment of Bank-Fund Collaboration by Staff

Two surveys on the effectiveness and quality of collaboration between the Bank and the Fund were conducted in 2003, one surveying the views of the country authorities and the other surveying respective staff views. The data obtained indicate an overall positive evaluation of the state of Bank-Fund collaboration. More than 90 percent of Bank and Fund staff respondents claimed that the roles of the two institutions are either largely or fully clear, although most respondents reported that the respective roles are largely, rather than fully, clear. Some 90 percent of Bank and Fund respondents indicated that they often or always receive pertinent information, comments, and technical inputs from their counterparts in a timely manner. Respondents from both institutions invite each other to comment as part of their internal review process of draft Board documents (79 percent), and additional responses (also 79 percent) indicated that these views are either always or often taken into account.

At the same time, the survey findings reinforced some perceptions that point to tensions in collaborative process. Fund staff tend to see their Bank colleagues as being flexible in program design and in the coverage and enforcement of conditionality. Fund staff are more likely to have concerns about a lack of ambition in the Bank's timetable for reforms. For their part, Bank staff are more likely to view the Fund as uncompromising when it comes to program design and conditionality, and too optimistic about the pace and scope of reforms that are within the implementation capacity of the country or the political and social constraints faced by the authorities. With respect to duplication of conditionality, Bank staff indicate somewhat greater concern about duplication of conditionality in overlapping areas (35 percent). In contrast, only 9 percent of Fund respondents indicate some duplication, while 39 percent see none. On the reasons for duplication, 72 percent of staff responses indicated that the duplication was because the measures were considered critical to both institutions' programs.

Source: *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality – Progress Report* (SecM2004-0070), February 24, 2004.

144. ***Lead Agency and Criticality.*** The concept of the "lead agency" was introduced in 2001 to ensure clarity of roles, improve accountability, and increase transparency in the Bank-Fund collaboration.[26] It was designed to recognize an institution's views in those areas where it takes the lead. A clear upstream collaboration between the teams of both institutions enhances the efforts by both institutions to streamline conditionality, while allowing borrowing countries to exploit the expertise gains that a collaborative approach offers them. Individual country teams are expected to jointly set out the respective roles of each institution in support of country programs, designating one of the two institutions as the lead agency for dealing with specific policy issues. In designating the lead agencies, the teams should be guided by the division of labor stated in the existing agreements on Bank-Fund collaboration. As stated in the 2001 Bank-Fund paper: "Each institution would retain ultimate responsibility for its own lending decisions, and conditions critical for the success of the respective institution's program would continue to be

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[26] See *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality* (SecM2001-0461), August 23, 2001.

specified in that institution's own arrangements, with lead agency staff advising both institutions on the substantive content. Conditionality would be duplicated only when a policy measure was considered critical for the success of the programs supported by both institutions. In such cases, conditionality would be harmonized, using identical dates and benchmarks to the extent possible."[27] These arrangements have been reflected in operational guidance to staff in both institutions:

- ***IMF.*** The 2002 IMF guidelines on conditionality acknowledge that the Fund's conditions would "normally" be within the Fund's core areas of responsibility. With respect to measures outside the Fund's core areas, the guidelines suggest that these "may also be established as conditions but may require more detailed explanation of their critical importance."[28] The recent Fund review of conditionality[29] further confirms that "the criticality criterion applies to all measures—whether they are in the Fund's core areas or outside, or whether they are or are not covered by another agency's (e.g., the World Bank's) conditionality."

- ***World Bank.*** The Bank's operational policy for development policy lending states that "in preparing development policy operations, the Bank collaborates with the IMF and other international financing institutions and donors, as appropriate, while retaining responsibility for its financing decisions" and affirms that "the Bank seeks to harmonize conditions with other development partners in consultation with the country."[30] The Bank's good practice guidance to staff further elaborates that "all partners must share a clear understanding about the modalities of their cooperation with a view toward minimizing transaction costs and avoiding inconsistencies in the conditions associated with the support from the various partners." It clarifies that the reform programs associated with an operation "need not include measures intended to correct weaknesses in the macroeconomic policy framework per se," unless a country's fiscal program or balance of payments and associated debt dynamics are not sustainable in the medium term, or that the risks to sustainability are excessively high, in which case "measures … associated with a formal IMF program … should normally satisfy the Bank."[31]

145. ***Institutional Differences.*** The Bank and the Fund can effectively complement each other even when there are overlaps in the areas of responsibility. Good communication between the country teams can help overcome institutional impediments to Bank-Fund collaboration. There is an established practice of exchanging information and technical inputs in program design, as well as of participating in the internal review process of the other institution. At the same time, in their responses to the survey undertaken for the progress report in strengthening Bank-Fund collaboration, staff from both institutions emphasized differences in institutional strategy and management styles, internal bureaucracy, and poor personal relations among institutional factors impeding collaboration.

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[27] See *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality* (SecM2001-0461), August 23, 2001.

[28] See *Guidelines on Conditionality* (IMF, Decision No. 12864-(02/102)), September 25, 2002.

[29] See *IMF Review of the 2002 Conditionality Guideline*s (SM/05/81), March 4, 2005.

[30] OP 8.60, *Development Policy Lending*, paragraphs 7 and 13.

[31] See *World Bank Good Practice Note: Designing Development Policy Operations*, OPCS, October 2004.

146. ***Harmonization with Other Donors.*** The Bank and the Fund are only two of many donor agencies providing aid to the countries. In aid-dependent countries with a large donor presence, aggregate conditionality should be considered in a broader context of donor harmonization, with other donors offering their assistance in support of countries development programs. In particular, as bilateral donors are replacing traditional project financing with direct budget support in support of PRSPs in low-income countries, the need for a systematic approach to conditionality is recognized. Joint policy matrices and performance frameworks require the Bank and the Fund to find ways to further the harmonization agenda while maintaining their own distinct accountability.

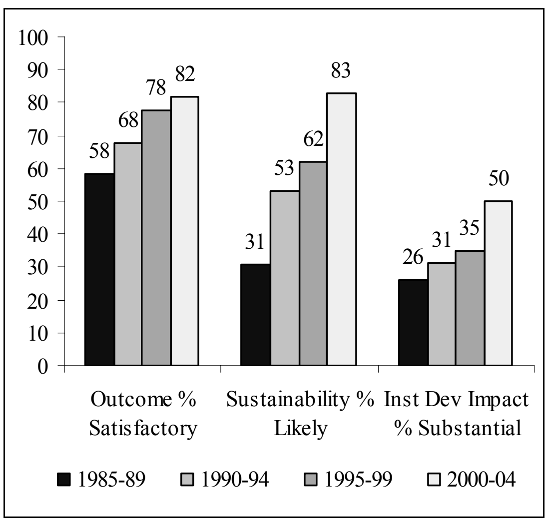
IX. QUALITY, COMPLIANCE, AND RESULTS FOCUS

A. Quality and Compliance

147. OED evaluations indicate that most World Bank policy-based operations meet their development objectives, are likely to be sustainable, and have significant impacts on institutional development—with significant improvements over the past decade. Operations are considered to have satisfactory outcomes if they achieve or exceed their main goals; this includes the relevance of and compliance with conditionality. OED complements its outcome rating with ratings of long-term sustainability (an assessment of resiliency to risk) and institutional development (the contribution of the operation to capacity building).[32]

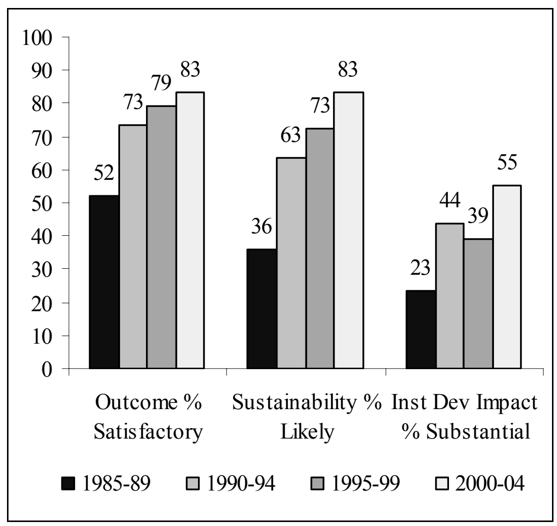
148. ***Outcomes.*** OED outcome ratings, weighted by policy-based operations, increased from around 60 percent satisfactory in the 1980s to 68 percent in first part of the 1990s, to 78 percent in the second part of the 1990s, and continued to increase to 82 percent in the first part of the 2000s (see Figure 98). Considering OED outcome ratings in dollar terms, weighted by disbursement amounts, also reveals a similar trend of improvement throughout the two decades starting in FY85 (see Figure 99). Outcome ratings in policy-based loans and investment loans exiting in FY04 have on average the same quality at exit, 78 percent satisfactory, reflecting a slight improvement in investment lending ratings in FY04 exits and a slight deterioration in policy-based lending ratings.

Figure 98. OED Quality-at-Exit Ratings, FY85-04, in percent, weighted by operations



Source: OED data.

Figure 99. OED Quality-at-Exit Ratings, FY85-04, in percent, weighted by disbursements



Source: OED data.

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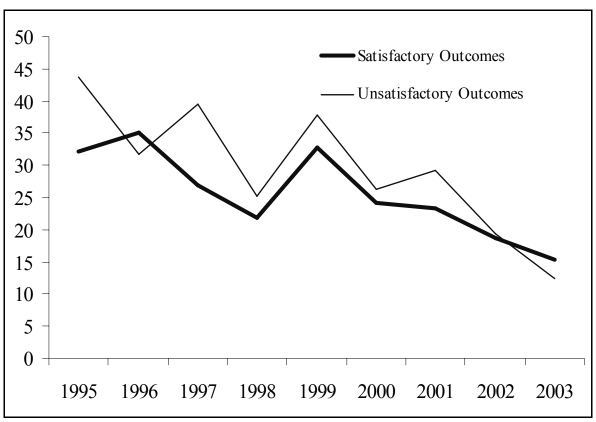
32 OED rates outcomes on a six-point scale: highly satisfactory, satisfactory, marginally satisfactory, marginally unsatisfactory, unsatisfactory, and highly unsatisfactory. Overall sustainability is rated on a four-point scale: highly likely, likely, unlikely, and highly unlikely. Overall institutional development impact is rated on a four-point scale: high, substantial, modest, and negligible. Borrower compliance with covenants and agreements is rated on a four-point scale: highly satisfactory, satisfactory, unsatisfactory, highly unsatisfactory.

149. ***Sustainability and Institutional Development Impact.*** The likely sustainability of policy-based operations also increased considerably, from 31 percent in loans exiting the second part of the 1980s to 83 percent in the first part of the 2000s, as did their institutional development impact, which doubled from 26 percent to 50 percent in two decades (see Figure 98 and Figure 99). Sustainability ratings are higher in policy-based lending than in investment lending, but the opposite happens in institutional development ratings, where investment lending ratings are higher.

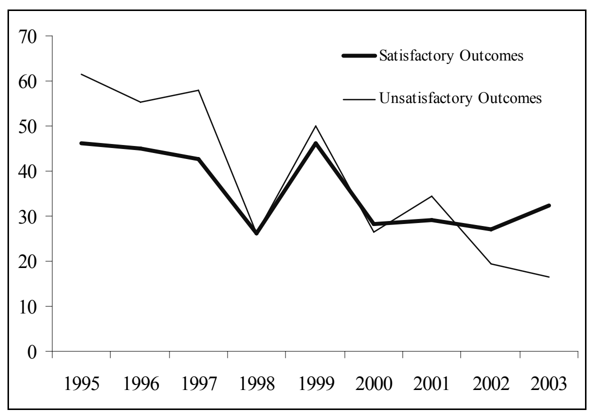
150. ***Conditions by Outcome Rating.*** Loans approved between FY96-FY01 and rated by OED as unsatisfactory for outcomes had on average a somewhat higher number of loan conditions than loans with satisfactory ratings (see Figure 100). OED ratings only cover around 70 percent of loans approved in FY02-03, and 92 percent of loans approved during the previous three fiscal years. On the basis of this subset of rated loans, this trend appears to have changed in FY03, as loans approved in that year and rated unsatisfactory by OED for outcomes contain slightly fewer conditions. However, when analyzing the same subset of loans and considering conditions and benchmarks together, loans with a higher number of conditions and benchmarks perform better on average than loans with a lower number of conditions and benchmarks (see Figure 101). This finding must be treated with great caution as the data do not reflect the ratings of loans driving the recent growth in the use of benchmarks, particularly in programmatic loans.

Figure 100. Avg. Number of Conditions in Loans with Satisfactory and Unsatisfactory OED Outcome Ratings, FY95-03



Source: ALCID and OED data.

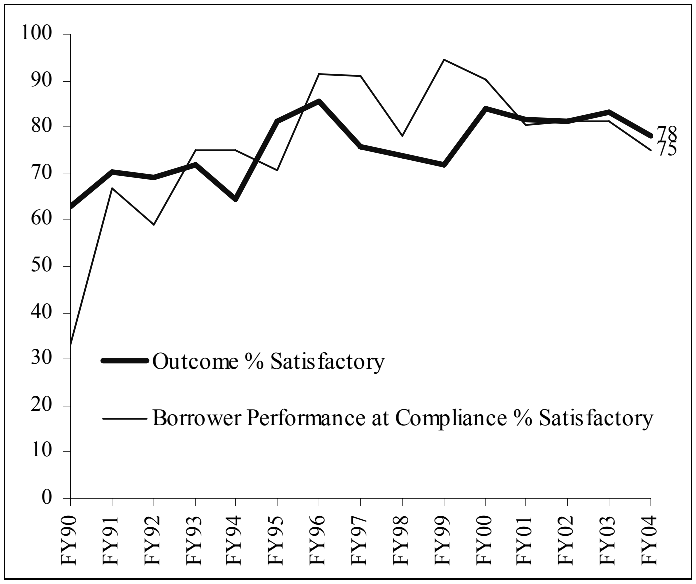
Figure 101. Avg. Number of Conditions and Benchmarks in Loans with Satisfactory and Unsatisfactory OED Outcome Ratings, FY95-03



Source: ALCID and OED data.

151. ***Compliance.*** The Bank also rates borrower compliance with all major covenants and commitments undertaken by the borrower as part of the loan conditions. The record on borrower compliance has been declining since FY99, from 95 percent to 75 percent in FY04 exits (see Figure 102)—reflecting an increase in loans where borrowers are failing to met all, most, or some major covenants and commitments. There is also some correlation in recent trends in borrower compliance and trends in overall outcomes—both appear to be moving to the same direction. However this finding represents only a subset of the total and must be treated with care as 30 percent of loans approved in FY02-03 have not been rated for borrower compliance.

Figure 102. OED Outcomes, OED Borrower Performance at Compliance, and Number of Exit Operations, FY90-04



Source: OED data.

B. Results Focus

152. This section reviews the results focus of policy-based operations. It identifies different types of results, drawing on the concepts defined in the recent Board paper on results-based CASs to identify the linkages between the Bank's interventions and long-term development goals and applies them to the analysis of loan components in policy-based loans.[33] This preliminary analysis is based on a small sample of 54 recent Implementation Completion Reports[34] of loans approved between FY02-04. Table 11 shows some examples of the results chain found in a select number of loans. For instance, Example 5 shows how a condition to create a new unit for public expenditure analysis and monitoring in a Ministry led to a stronger internal auditing system and new codes and monitoring measures. But national turbulence occurring during the implementation of the loan resulted in weak standardization of processes and a marked deterioration in public expenditure management. Consequently, governance and fiscal transparency suffered in the medium to long term. This example shows the effect of some unintended events in the results chain.

153. ***Preliminary Findings.*** Conditionality in World Bank policy-based operations supports a broad spectrum of results. The following are initial results (see Table 12):

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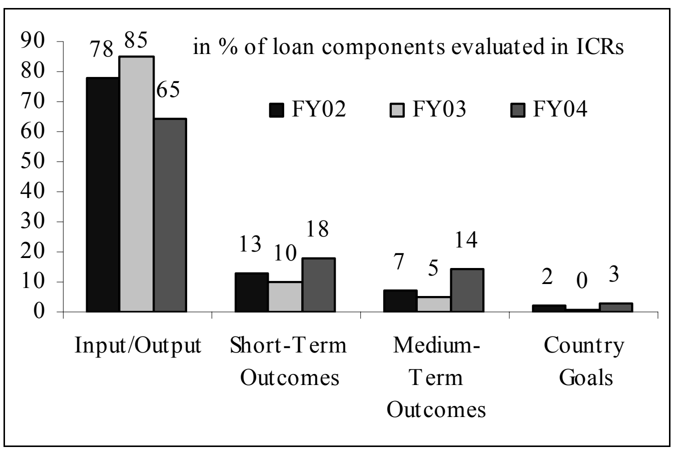
[33] See *Results Focus in Country Assistance Strategies: A Stocktaking of Results-Based CASs* (R2005-0042), February 24, 2005, Page 8.

[34] Recognizing the special nature of programmatic loans in that the series of individual loans is designed to achieve a single list of objectives over a predetermined time table, OPCS and OED have agreed on a simpler Implementation Completion Report (ICR) for each operation in a series except the last. Thus, full ICRs of programmatic series are done after the completion of the series and each individual programmatic loan in the series is required to prepare a simplified ICR where an assessment of the impact on results is not required.

- ***Content of results.*** Most conditions achieve results that consist of input and output activities. On average, around 80 percent of conditions generate input/output activities (see Figure 103). The expectation is that these will in turn generate outputs and future outcomes and results. In FY04, this share declined to 65 percent from around 80 percent the previous two years.
- ***Emerging trend.*** There is an emerging trend in conditions that contribute to near-term and long-term outcomes or results in loans approved in FY04. Although it is still early to assess with a high degree of accuracy the impact conditions are having on outcomes, on the basis of the small sample of loans evaluated to date and the recent evolution of programmatic loans, the share of loans with short-term outcomes has increased from 13 percent in FY02 loans to 18 percent in FY04 loans. In a similar vein, the share of higher-order, medium-term outcomes increased in recent years, mainly because of the introduction of programmatic loans.
- ***Millennium Development Goals and other country development objectives.*** Between 2-3 percent of conditions consist of country development objectives or MDG-related goals.

Figure 103. Share of Conditions in the Results Chain, Selected ICRs for Loans Approved FY02-04



Source: Selected ICRs and OPCS.

Table 11. Examples of the Results Chain in Recent Development Policy Loans (based on ICRs)

		Example 1 Cocoa Price Reform (Positive Outcome)	**Example 2 Cocoa Price Reform (Negative Outcome)**	**Example 3 Financial Sector Reform (Positive Outcome)**	**Example 4 Health Sector Reform (Positive Outcome)**	**Example 5 Public Governance Reform (Negative Outcome)**
	Loan Condition	The borrower has commenced the compensation of cocoa farmers	Launch of a study on the regulatory framework in cocoa production	Central bank launched a new system to reduce systemic risk	Issue decision creating a health care fund for the poor	Integrated public financial management system and a review of procurement procedures
Results Chain	**Input**		A study on the cocoa industry	Legislation to improve safety and soundness of financial system		Government created a new unit for systemic public expenditure analysis and monitoring
	Activity		The study found that there were likely problems of management, the use of funds, and lack of full cooperation by some regulatory bodies	Activities to promote safer and sounder financial system	Creation of health care fund for the poor	Stronger internal auditing system and new codes and measures are prepared
	Output	Measures taken to raise cocoa price	Authorities did not follow up and only introduced minor measures	Stronger regulatory framework, more proactive supervision, and better information	Funds used for low-income regions' hospitals and clinics	Budget implementation was severely disrupted by the national turbulence
	Short-term Outcome	Increased incomes of cocoa producers	Little improvement happened to the incomes in the industry	Private banks' lending increased owing to improved safety and soundness	Health services delivered to low-income areas	Standard processes could not be observed
	Medium-term Outcome	Raised incomes of rural area	Confidence in the private sector remains low and sustained return of foreign investors is yet to happen	Private banking system shows improved profitability and stability	Low-income mothers have guaranteed access to health care pre/post delivery	Public expenditure management deteriorated
	Country Development Goal	Reduced poverty	Little contribution to improving the economy	The likelihood of systemic problems diminished	Reduced infant mortality rate	Governance and fiscal transparency deteriorated

Source: Selected loans.

Table 12. Loans with ICRs and Results Chain Analysis

										Results Framework				
Project ID	Title	Country	Country Group	Tranche	Programmatic (yes/no)	Simplified ICR (yes/no)	Amount	ICR Date	Approval FY	Input/ Output	Short-Term Outcomes	Med-Term Outcomes	Country Goal (MDGs)	Total Loan Components
P076905	Energy Sector Reform Loan	Brazil	IBRD	One	no	no	455	06/26/2003	2002	6	1	0	0	7
P070693	PAL	Ukraine	IBRD	Two	yes	no	250	06/29/2003	2002	3	5	1	0	9
P050619	ERSO III	Ghana	IDA	One	no	no	110	06/30/2003	2002	6	0	0	1	7
P066259	BR Prgrm.Fincl Sctr II	Brazil	IBRD	One	no	no	404	09/26/2003	2002	4	5	2	1	12
P074750	MX Tax Reform Adjustment Loan	Mexico	IG IBRD	One	no	no	303	10/23/2003	2002	2	0	0	0	2
P074642	SL - ERRC II	Sierra Leone	LICUS	Two	no	no	50	11/06/2003	2002	14	0	0	0	14
P074486	PFSAC	Yugoslavia, Fed	Blend	One	no	no	85	12/19/2003	2002	3	1	1	0	5
P074585	Ethiopia Structural Adjustment Credit	Ethiopia	IDA	One	no	no	120	12/20/2003	2002	12	1	0	0	13
P075700	Structural Adjustment Credit	Cape Verde	IDA	Two	no	no	15	12/23/2003	2002	3	0	2	0	5
P069569	LKD Public Expenditure Adjustment Credit	Niger	LICUS	Two	no	no	70	12/29/2003	2002	8	1	0	0	9
P073572	CO Structural Fiscal Adjustment Loan	Colombia	IBRD	Three	no	no	400	12/29/2003	2002	5	1	0	0	6
P070560	PFPSAL 2	Turkey	IBRD	Three	yes	no	1350	01/29/2004	2002	9	1	0	0	10
P065163	SAC 3	Moldova	IDA	Three	no	no	30	03/31/2004	2002	7	7	0	0	14
P067223	SAL	Croatia	IG IBRD	Two	no	no	202	04/29/2004	2002	9	2	1	0	12
P071375	CI: ERC	Cote d'Ivoire	LICUS	Three	no	no	200	05/21/2004	2002	3	1	2	0	6
P057293	CD-Econ Recovery Credit SAL (FY02)	Congo, Democrat	LICUS	Three	no	no	450	06/21/2004	2002	6	0	1	0	7
P065790	DJ FISCAL CONSOLIDATION CREDIT	Djibouti	IDA	Two	no	no	10	06/23/2004	2002	4	0	0	0	4
P055815	TN-ECAL III	Tunisia	IBRD	Four	no	no	253	06/29/2004	2002	6	0	0	1	7
P066154	PSMAC	Macedonia, form	IBRD	One	no	no	15	06/29/2004	2002	14	0	0	0	14
P072785	ML - SAC III	Mali	IDA	Three	no	no	70	06/30/2004	2002	3	0	1	0	4
P055131	SAC 2	Azerbaijan	Blend	Two	no	no	60	09/02/2004	2002	13	1	0	2	16
P072106	BF PRSC 1	Burkina Faso	IDA	One	yes	yes	45	12/29/2004	2002	10	0	0	0	10
P064542	EFSAL	Slovak Republic	IG IBRD	Three	no	no	177	02/14/2005	2002	6	2	0	0	8
P075810	Sindh Structural Adjustment Credit	Pakistan	Blend	One	no	no	100	06/23/2003	2003	3	0	0	0	3
P077834	NWFP Structural Adjustment Credit	Pakistan	Blend	One	no	no	90	06/23/2003	2003	5	0	0	0	5
P073817	PE-Programmatic Social Reform Loan II	Peru	IBRD	One	yes	no	100	06/27/2003	2003	9	1	1	0	11
P066826	JO-PSRL II	Jordan	IBRD	One	no	no	120	06/30/2003	2003	7	0	0	0	7
P069861	CO- Social Sector Adjustment	Colombia	IBRD	One	no	no	155	06/30/2003	2003	3	1	0	0	4
P073756	JM Bank Restructuring and Debt Mgmt. II	Jamaica	IBRD	One	yes	no	75	06/30/2003	2003	5	1	1	0	7
P082739	EC FISCAL CONSOLID. & COMP. GROWTH	Ecuador	IBRD	One	yes	no	50	02/26/2004	2003	11	0	0	0	11
P081718	LK-PRSC	Sri Lanka	IDA	One	yes	yes	125	06/18/2004	2003	7	0	3	0	10
P073851	GY Poverty Red. Support Credit I (PRSC)	Guyana	IDA	One	yes	yes	12	06/22/2004	2003	3	3	1	0	7
P074539	MX Programmatic EnvSAL	Mexico	IG IBRD	Two	yes	yes	202	06/23/2004	2003	4	0	0	0	4
P070641	BR-PRGM.FISCAL REF II	Brazil	IBRD	One	yes	no	404	06/25/2004	2003	5	1	2	0	8
P075398	Vietnam PRSC II	Vietnam	IDA	One	yes	no	100	06/28/2004	2003	10	7	5	2	24
P077781	TD-Structural Adj Credit SAL 5 (FY03)	Chad	LICUS	One	no	no	40	06/28/2004	2003	5	0	0	0	5
P082395	EC-FIRST PROGRAMMATIC HUMAN DEV. I	Ecuador	IBRD	One	yes	yes	50	06/29/2004	2003	3	0	0	0	3
P081845	Development Support Credit	Bangladesh	IDA	One	no	no	300	06/30/2004	2003	4	0	0	0	4
P083074	AR Economic & Social Transition	Argentina	IBRD	One	no	no	500	06/30/2004	2003	5	0	0	0	5
P078380	ECON ASST 4	Kosovo	LICUS	One	no	no	5	07/30/2004	2003	5	0	0	0	5
P082700	BO Social Safety Net SAC	Bolivia	Blend	Two	no	no	35	12/21/2004	2003	3	3	0	0	6
P075378	BF PRSC 2	Burkina Faso	IDA	One	yes	yes	35	12/29/2004	2003	9	0	0	0	9
P075758	SAC 5	Armenia	IDA	Two	no	no	40	12/30/2004	2003	8	1	0	0	9
P081402	BO Decentr. PSAC II	Bolivia	Blend	One	yes	no	25	12/30/2004	2003	13	3	0	0	16
P074072	TZ PRSC1	Tanzania	IDA	One	yes	no	132	02/02/2005	2003	12	0	0	0	12
P079060	CO 1st PSAL Labor & Soc Ref	Colombia	IBRD	One	yes	yes	200	10/14/2004	2004	6	0	0	0	6
P083905	CO Prog Fiscal and Institutional Adj II	Colombia	IBRD	One	yes	no	150	10/28/2004	2004	11	0	0	0	11
P078951	PE-Programmatic Social Reform III	Peru	IBRD	One	yes	yes	150	12/21/2004	2004	5	3	0	0	8
P078841	DM ERSO	Dominica	Blend	One	no	no	3	12/28/2004	2004	9	2	0	0	11
P076908	BF PRSC 3	Burkina Faso	IDA	One	yes	no	50	12/29/2004	2004	1	4	5	3	13
P074081	UG-PRSC 3 (FY04)	Uganda	IDA	One	yes	no	150	03/18/2005	2004	16	0	5	1	22
P075191	AP SAL II	India	Blend	One	no	yes	220	03/24/2005	2004	5	4	2	0	11
P083228	Punjab Education Sector Adjustment Credi	Pakistan	Blend	One	no	yes	100	03/29/2005	2004	8	1	1	0	10
P074685	Poverty Reduction Support Credit I	Nepal	IDA	One	yes	yes	70	04/27/2005	2004	4	4	5	0	13

Source: Selected ICRs and OPCS.

REVIEW OF WORLD BANK CONDITIONALITY
BACKGROUND PAPER 4

CONTENT OF CONDITIONALITY IN WORLD BANK POLICY-BASED OPERATIONS: PUBLIC SECTOR GOVERNANCE, PRIVATIZATION, USER FEES, AND TRADE

PREM GROUP
WORLD BANK

ABBREVIATIONS AND ACRONYMS

AFR	Africa Region
ALCID	Adjustment Lending Conditionality and Implementation Database
EAP	East Asia and Pacific Region
ECA	Europe and Central Asia Region
FY	Fiscal Year
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank of Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
LCR	Latin America and Caribbean Region
MNA	Middle East and North Africa Region
MTEF	Medium-Term Expenditure Framework
NAFTA	North American Free Trade Agreement
OED	Operations Evaluation Department
OPCS	Operations Policy and Country Services
PFM	Public financial management
PRSC	Poverty reduction strategy credit
PRSP	Poverty Reduction Support Paper
SAR	South Asia Region
SOE	State-owned enterprises
WTO	World Trade Organization

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CONTENT OF CONDITIONALITY IN WORLD BANK POLICY-BASED OPERATIONS: PUBLIC SECTOR GOVERNANCE, PRIVATIZATION, USER FEES, AND TRADE

CONTENTS

Content of Conditionality in World Bank Policy-Based Operations: Public Sector Governance, Privatization, User Fees, and Trade

Executive Summary

1. This note investigates the characteristics of conditions and benchmarks in World Bank policy-based lending in the areas of public sector governance/fiscal policy, privatization, user fees, and trade. These areas have long been central to the debate on the role of conditionality in policy-based lending and have often been the subject of controversial discussions both within and outside the World Bank. Together, they constitute slightly over 50 percent of total conditions and benchmarks in development policy lending.

2. This note finds that there has been a significant change in the content and composition of conditions and benchmarks since 1980. The main finding is that the Bank programs now place greater emphasis on institution building and governance issues in all areas of intervention. The emphasis on governance issues is particularly important in IDA countries. Other findings include the following:

- The relative importance of public sector governance issues has increased. Specifically, public expenditure, financial management, and procurement conditions have grown in importance. This trend corresponds to a stronger attention on improved alignment of resources with development priorities and on efficiency of resource use. Consistent with the objective of building more efficient institutions, administrative and civil service reform conditions have become central to development policy lending operations.

- The emphasis on privatization has declined compared to 1990s, when transition economies devoted considerable efforts to privatization. The shift away from privatization is also related to the increased attention to the quality of the investment climate as a whole. In noncompetitive sectors, independently of the ownership structure, the institutional framework has become central to the design of reforms.

- Contrary to common perception, user fee conditions are extremely limited in policy-based lending operations. Where used, they figure more prominently in the power sector (where they are concentrated in Eastern Europe and Latin America) and are virtually nonexistent in health, education, and water.

- Trade conditions and benchmarks in policy-based operations have declined significantly since the mid-1980s; they now account for less than 2 percent of the total number of conditions and benchmarks. The initial emphasis was on the removal of quantitative restrictions to trade and on non-trade barriers. Today, when considering support for international trade the focus of development policy operations is on institutional issues, such as the performance of customs agencies, product quality, and certification. The World Trade Organization and regional trade agreements have become the main forum for discussions of trade issues.

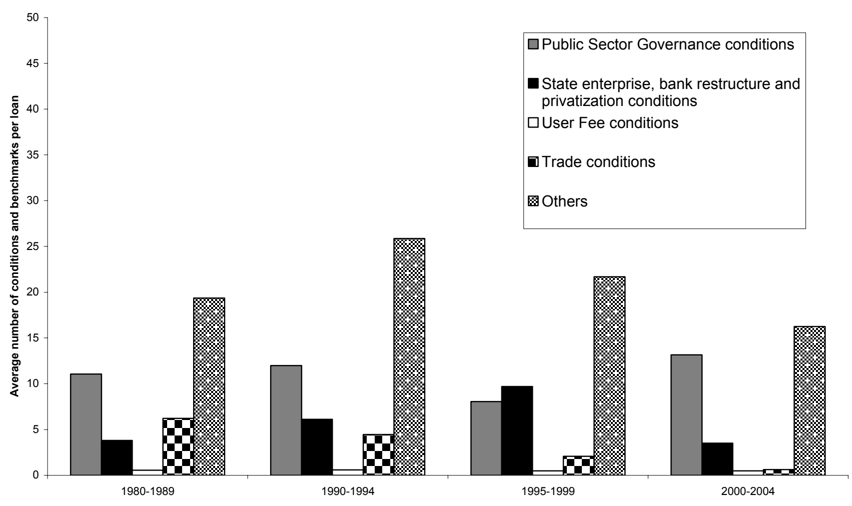
CONTENT OF CONDITIONALITY IN WORLD BANK POLICY-BASED OPERATIONS: PUBLIC SECTOR GOVERNANCE, PRIVATIZATION, USER FEES, AND TRADE

I. INTRODUCTION

1. This paper presents the content of conditionality in World Bank policy-based lending, with a focus on public sector governance, privatization, user fees and trade. It is one of the series of background policy papers prepared in response to the Development Committee's request in its October 2004 meeting for review of the World Bank policy and practice on conditionality.[1] The review documents the evolution of the Bank's approach to conditionality, takes stock of the lessons of experience, and outlines current Bank's practice of conditionality. As a contribution to the review, this paper analyzes the evolution and characteristics of conditions and benchmarks related to governance, privatization, trade and user fees.

2. ***Paper Content.*** Conditions and benchmarks in the areas of public sector governance/fiscal policy, privatization, users' fees, and trade cover approximately 50 percent of total conditions and benchmarks in World Bank policy based lending (see Figure 1). This note briefly summarizes the salient features shaping the debate inside and outside the World Bank on each of the themes investigated, and then analyzes the content of conditionality in policy-based lending as it has evolved over time and across Regions. The note does not attempt to assess the effectiveness of conditionality or client compliance with it.

Figure 1. Average Composition of Conditions and Benchmarks Per Loan



3. ***Overview of Trends.*** While the four areas under review account, on average, for about half of the conditions and benchmarks in loans since the early 1980s, their relative importance has changed over time. Privatization conditions and benchmarks are still relevant today, but they have declined considerably since their peak in the second half of the 1990s. Trade conditions and benchmarks have progressively diminished in importance; today their share is almost nil. User fees have never been prominent in policy-based operations and account for a very small share in the composition of conditionality. On the other hand, the content of conditionally has progressively shifted toward the development of stronger and more effective institutions, which

1 See *Review of World Bank Conditionality: Issues Note* (CODE2005-0002), January 11, 2005.

has translated to an increased focus on public sector governance conditionality. Over the last 25 years, it has become increasingly clear that without an effective government and properly functioning institutions it is difficult to advance a sustainable development agenda. Thus, conditionality has increasingly emphasized public sector governance as a key area of Bank support, particularly in IDA countries (where governance figures prominently in the Bank's performance–based allocation system), and has made support for institution building a priority. In addition, the review finds that the design of conditionality has been tailored to country/regional characteristics and that there is now increased attention to the potential distributional consequences of reforms.

4. ***Data Sources and Limitations.*** Unless otherwise specified, this note is based on the Adjustment Lending Conditionality and Implementation Database (ALCID) maintained by Operations Policy and Country Services (OPCS). ALCID currently covers 696 operations between 1980 and 2004, which encompass over 28,000 conditions classified in thematic and sector groups. The analysis that follows includes both legally binding conditions and desirable policy actions (benchmarks) because this better allows for a comprehensive understanding of the areas covered and trends over time. Therefore, unless otherwise noted, all tables and related discussion are on both conditions and benchmarks. The Annex A recalculates the main tables for binding conditions only. The results indicate that the trends described in this note are not sensitive to the inclusion of benchmarks alongside binding conditions.

5. Actual statements of conditionality in ALCID are typically restricted to one sentence, and do not reveal the full extent of the emphasis placed either explicitly or implicitly in program documents on particular government actions. Consequently, the available information can only provide limited insights into the patterns of interlinkages between different types of conditionality within an operation or across sets of operations over time for a given country. Additionally, while the specific design of conditions emerges from underpinning analytic work and country dialogue, the evidence presented here does not enable elaboration on these links.

6. ***Note Organization.*** This note is organized as follows: Section II explains the use of conditions and benchmarks in public sector governance, privatization, user fees and trade. Each sub-section presents an overview of the issues, evolving practices, salient features, and trends in each of these four areas. Section III concludes with a summary of key findings.

II. USE OF CONDITIONALITY

7. In the last three decades, a series of events has shaped the debate over the role of the state in promoting the well-being of society: (a) the collapse of planned economies in Central and Eastern Europe; (b) the fiscal crisis of the welfare state throughout the world; and (c) the collapse of the state and the explosion of humanitarian crises in many developing countries.[2] Spurred by these events, a wide array of issues and views has emerged to shape the discussion of the role of governments in development. In sum, government effectiveness is now viewed as a defining component of any credible poverty reduction strategy, because in many countries governments have failed to deliver even on fundamental public goods such as property rights, roads, and basic health and education. However, it is recognized that the constituent elements of effective government vary across countries at different stages of development, and that even for countries

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[2] World Bank 1997.

at the same income level, differences in population size, ethnic composition, culture, or political systems make every state unique.

A. Public Sector Governance/Fiscal Policy

8. The nature of World Bank operations reflects the new emphasis on supporting efforts to enhance government effectiveness; since the mid-1990s, governance issues as a whole have became central in policy-based lending, with a clear shift away from the typical structural adjustment operations of the 1980s and early 1990s, which dealt mainly with macro and fiscal stabilization issues and liberalization of the state sector. Progressively, the World Bank has set up a strategy to support developing country government efforts to increase their effectiveness. The basic tenets of the approach are: (a) define the role of the state on the basis of its capacities, and (b) increase capacity over time by strengthening public institutions. These tenets, in turn, may lead to a host of interventions aimed at an effective definition of the priority areas of intervention given resource and capacity constraints, including designing effective rules and restraints, combating corruption, increasing the efficiency of public institutions, improving pay and incentive schemes for public employees, increasing state responsiveness to people's needs, and so forth.[3]

9. ***Governance.*** Support to public sector governance reforms has evolved considerably in the last 10 years, emphasizing a cross-cutting approach rather than stand-alone, discrete actions, and shifting from supply-side reforms and technical advice to governments, toward broader efforts to enhance domestic ownership and demand for reforms. As public sector governance has become central in many policy-based operations, new instruments have been introduced to address the need for greater flexibility and longer time horizons in such operations. Among such instruments are poverty reduction strategy credits (PRSCs)—which emphasize cross-cutting reforms to underpin budget support and a broader harmonization agenda focused on strengthening domestic institutions and processes—and development policy lending.[4]

10. ***Public Financial Management.*** Increasingly over the last 10 years, policy-based operations have focused on supporting reforms aimed at improving public financial management systems, from budget formulation and execution, to monitoring. Particularly in IDA countries, this has resulted in a shift from traditional investment projects to the provision of budget support, with increased attention on strengthening countries own fiduciary systems.[5] Efforts to promote Medium-Term Expenditure Frameworks (MTEFs) illustrate recent attempts to address fiscal policy issues. An MTEF seeks to link policy, planning, and budgeting over the medium term (e.g., three years). The process has two main objectives: the setting of fiscal targets and allocation of resources to strategic priorities within these targets. The Poverty Reduction Strategy Paper/Heavily Indebted Poor Countries (PRSP/HIPC) processes have provided an impetus for efforts to strengthen MTEFs. Initial experience in implementing MTEFs points to the need for adequate public expenditure management systems as a precondition for a successful implementation.[6]

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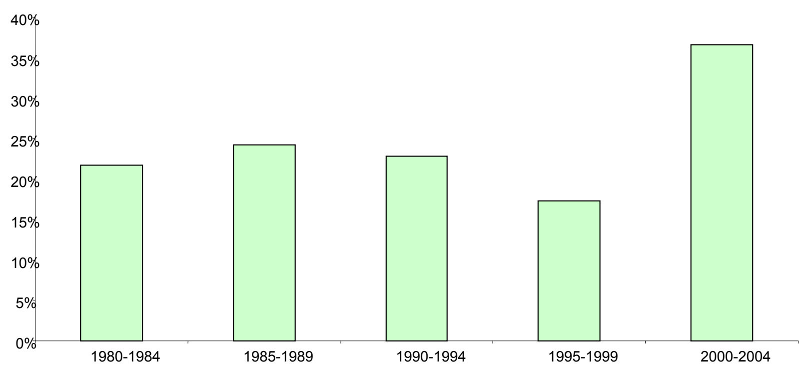
3 World Bank 2000; 2002a; and 2002b.
4 World Bank 2005a; and 2004a.
5 IMF and World Bank 2003.
6 IMF 2005.

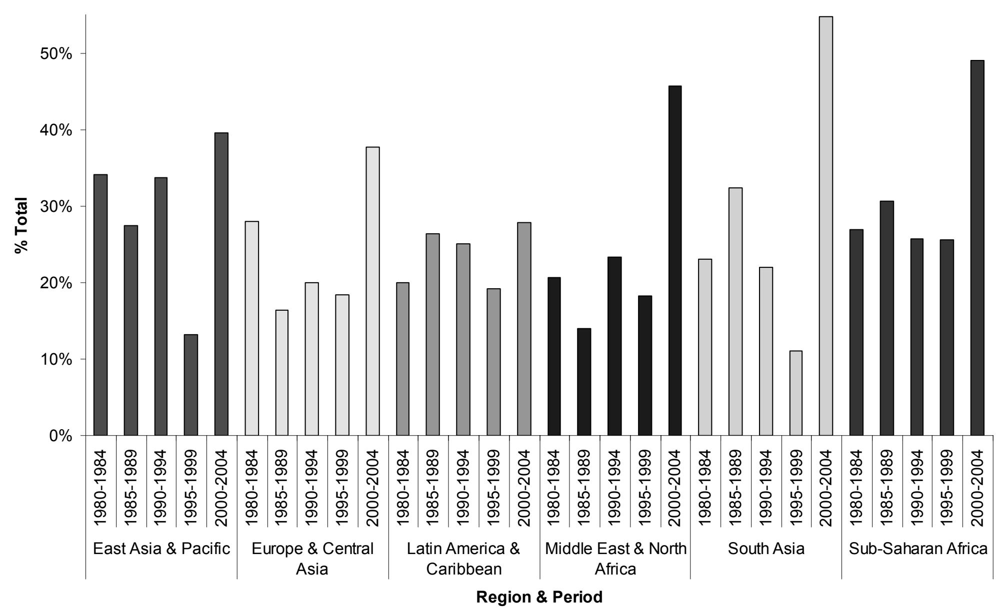
11. ***Overall Trend.*** Almost 39 percent of total conditions and benchmarks in policy-based operations now relate to public sector governance actions. In the last five years, public sector governance and fiscal policy-related conditions and benchmarks in policy-based lending have grown significantly as a share of the total. From levels of about 20 percent throughout the 1990s they now account for over one-third of the total (see Figure 2).

Figure 2. Public Sector Governance Conditions and Benchmarks
(% of total conditions and benchmarks)



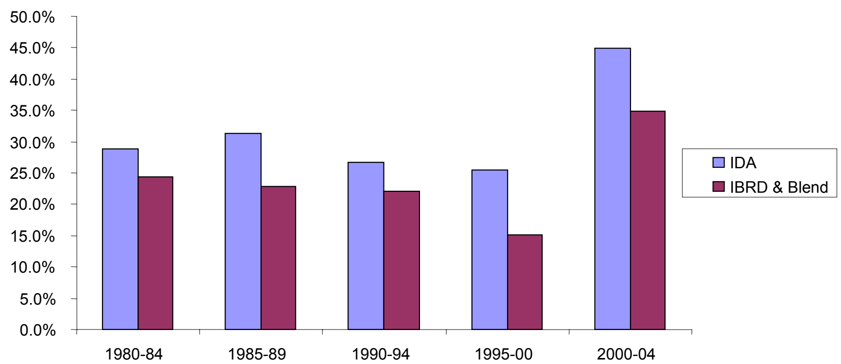
12. ***Regional Disaggregation.*** Public sector governance conditions and benchmarks have grown in importance across all Regions (see Figure 3). They are most pronounced in the South Asia (SAR) and Africa (AFR) and least applied in Latin America and Caribbean (LCR) Regions. The recent surge is most marked in South Asia, where they grew from the lowest base level of 10 percent to over half of the conditions and benchmarks during the 2004-2005 period. In Middle East and North Africa (MNA) and Africa Regions, the share is almost half.

Figure 3. Public Sector Governance Conditions and Benchmarks
(% of total conditions and benchmarks)



13. ***IDA Emphasis.*** The emphasis on public sector governance conditions and benchmarks is especially pronounced in IDA countries (see Figure 4). The increasing focus on strengthening institutional capacity and fiduciary systems has resulted in more policy-based operations in IDA countries with this type of conditions and benchmarks. Particularly in low-income countries, weak institutions and reliance on external budgetary funding call for more attention to public sector governance reforms.

Figure 4. Public Sector Governance Conditions and Benchmarks: IDA and IBRD Distribution



14. ***Shifts in Focus.*** Public sector governance encompasses a whole series of interventions. The ALCID database allows for seven distinct categories: public expenditure, financial management, and procurement (PFM); tax policy and administration; administrative and civil service reform; other public sector governance (which includes parastatal reform conditions); anticorruption measures; decentralization; and debt management. To date, the first four categories account for about 85 percent of conditions and benchmarks. Within public sector governance, the relative emphasis has evolved over time. Parastatal reforms and, to a lesser extent, tax policy and administration, are not as important as they formerly were, while in recent years civil service reform has increased, and PFM-related conditions and benchmarks have almost doubled from less than 20 percent of the total in the early 1980s to over 40 percent in the last five years (see Figure 5).

15. ***Trend toward PFM.*** The rising PFM trend is consistent with the increasing importance placed on country public financial systems. The HIPC initiative, for instance, has stressed the need for countries to meet conditions and benchmarks in 16 PFM areas, and support to accomplish this objective has been both the subject of conditionality and of direct assistance. Similarly, the increasing reliance on external budget support financing has emphasized the need for stronger PFM institutions.[7]

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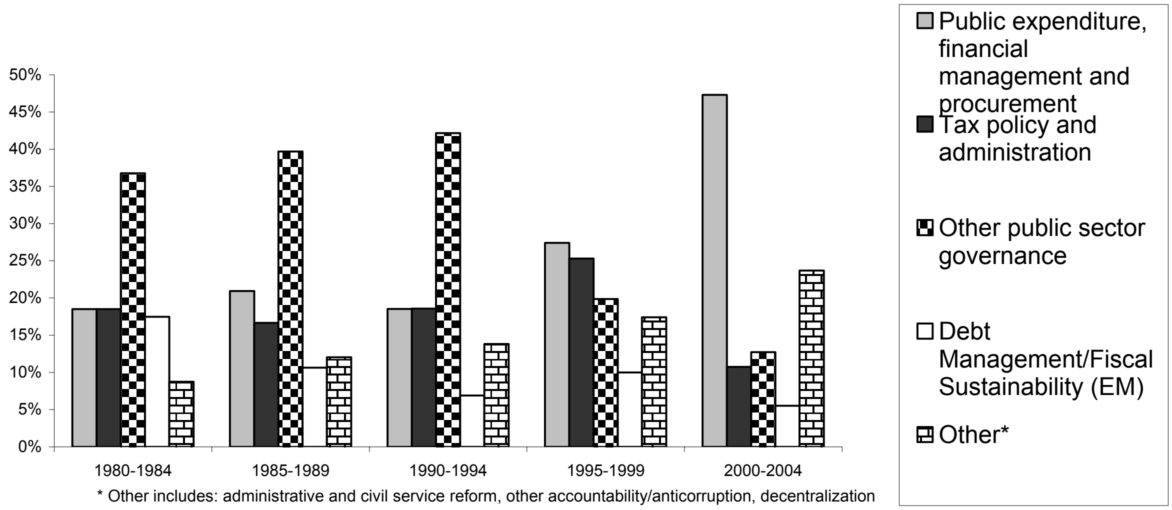
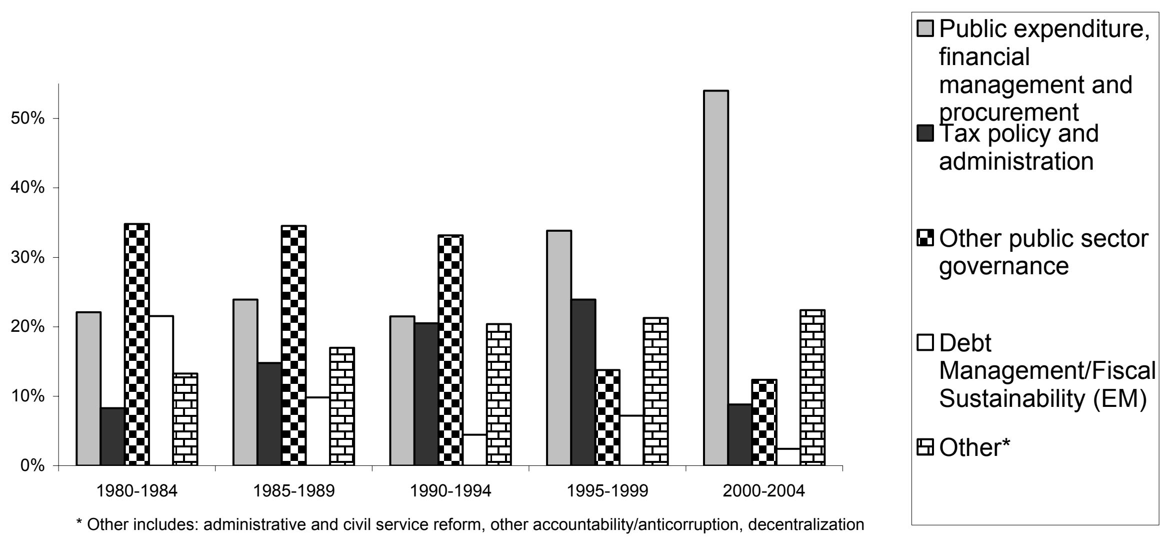
[7] Dorotinsky and Floyd 2004.

Figure 5. Composition of Public Sector Governance-Related Conditions and Benchmarks



16. ***IDA Country Focus.*** In IDA countries, the relative importance of PFM conditions and benchmarks is even more pronounced, accounting for over half of public sector governance conditions and benchmarks (see Figure 6). In general, low-income countries tend to have weaker public institutions and a higher share of financing in the form of budget support. Consequently, policy-based operations have stressed PFM measures as the necessary underpinning for effective government institutional strengthening.

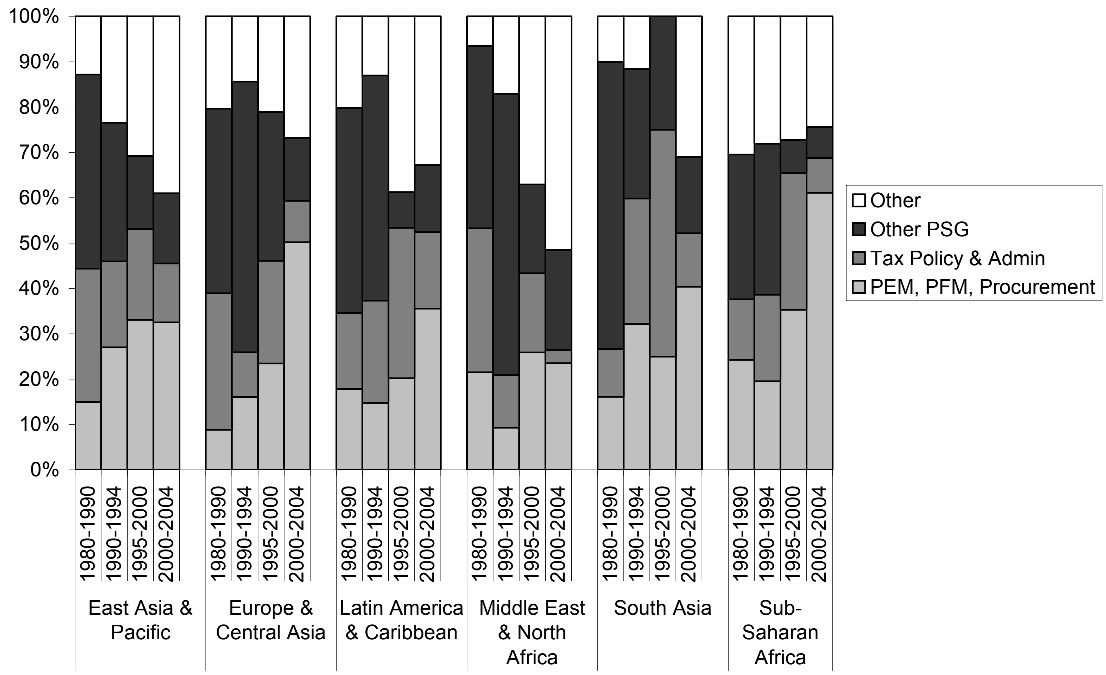
Figure 6. Composition of Public Sector Governance-Related Conditions and Benchmarks
(IDA Only)



17. ***Regional Variations.*** In response to different governance and institutional needs, the mix of conditions and benchmarks within the area of public sector governance varies greatly across Regions and over time (see Figure 7). In the last five years, policy-based lending in AFR, Europe and Central Asia (ECA), and (to a lesser extent) LCR has been highly concentrated on PFM-related reforms; in Africa alone, these conditions and benchmarks account for over 60 percent of

the total. Conversely, in the Middle East and North Africa Region, the focus of the early 1980s on tax policy has given way to conditions and benchmarks associated with administrative and civil service reforms, while PFM-related conditions and benchmarks have actually decreased in recent times.

Figure 7. Composition of Public Sector Governance-Related Conditions and Benchmarks



Others include: administrative and civil service reform, other accountability/ anticorruption, decentralization, debt management.

B. Privatization

18. The debate over privatization processes in developing countries has evolved over time as experience has presented governments with new issues to deal with. Focusing on the recent past, in the second half of the 1980s and first part of the 1990s, most of the debate concentrated on the fiscal implications of privatization (or lack thereof) as covering state enterprise losses through fiscal transfers often required governments to finance large fiscal deficits, increase tax revenues, or reduce public spending in other areas. Subsequently, issues of efficiency gains associated with privatization—particularly in the provision of key services to the population—became central to the debate as performance improvements were viewed by some as dependent on increased competition rather than a change in ownership. However, by the second half of the decade, it became evident that sound regulatory institutions and instruments were fundamental to the success of privatization (particularly in noncompetitive sectors), to the extent that for some, the failure of privatization is the failure of regulation. As such, the governance structure was more prominently taken into account in reform design. More recently, the equity implications of privatization processes became prominent in the debate, as initial assessments of privatization

processes highlighted instances of adverse distributional consequences associated with job losses or onerous tariff structures for essential services to poor people.[8]

19. ***Political Economy of Privatization.*** Today, it is increasingly clear that privatization is not a purely technocratic exercise but rather one that encompasses complex political economy issues. Particularly in noncompetitive industries, privatization is not only a matter of design but a matter of power, as one of the key issues is the distribution of natural monopoly rents. Governments often face pressure from interest groups that seek to secure the substantial rents associated with privatization. Such groups are at times able to exercise enough influence on the design of the reform to decrease the transparency of the process and distort the distribution of benefits. As a consequence, the ability to design adequate governance structures is central in limiting the opportunity for "program capture" by specific interest groups. Paradoxically, however, it is often in countries with weak governance as a whole—and thus low capacity to enforce adequate regulatory systems—that the need for privatization of poorly functioning public services is greater. The debate then centers on the costs and benefits associated with either a suboptimal public provision of service or a suboptimal regulation of privately provided services.

20. ***World Bank Role.*** These issues have also shaped the Bank's role in support of privatization efforts. A series of factors has now gained prominence in the design and implementation of privatization reforms so that these are better tailored to local conditions. In particular, there is a need to (a) ensure a better design of contracts; (b) guarantee a fair transaction process; (c) improve transparency in the use of privatization revenues; (d) investigate the distributional impacts and build mechanisms to compensate potential losers; (e) incorporate instruments to promote access and affordability in the provision of services; (g) devote attention to the design of regulatory systems; and (g) engage civil society in more productive discussions and herald the benefits of privatization efforts that have been pursued properly and effectively.

21. ***Privatization Assessment.*** The available evidence suggests that privatization of competitive industries has proven to be a success in terms of improving efficiency of enterprise performance.[9] The numerous assessments of privatization in competitive industries conclude that privatization improves performance, particularly in high- and middle-income countries. For noncompetitive industries, the critical issue is the precise welfare effects of privatization. Given the methodological difficulties associated with such an assessment, few studies have been carried out to date. These however indicate that privatization generates substantial welfare gains when implemented in the proper policy and regulatory setting.[10]

22. ***Macroeconomic Implications of Privatization.*** The few studies that have investigated the macroeconomic implications of privatization have shown an improvement in the fiscal position and a positive correlation with growth.[11] However, there are differences between competitive and noncompetitive industries. For infrastructure services, the evidence is that if, on average, fiscal gains have indeed been achieved, they were often not as high as initially hoped for, in particular when contracts ended up being renegotiated (as, for instance, in 75 percent of the cases in water and transport in Latin America).[12] The same distinction is relevant for the

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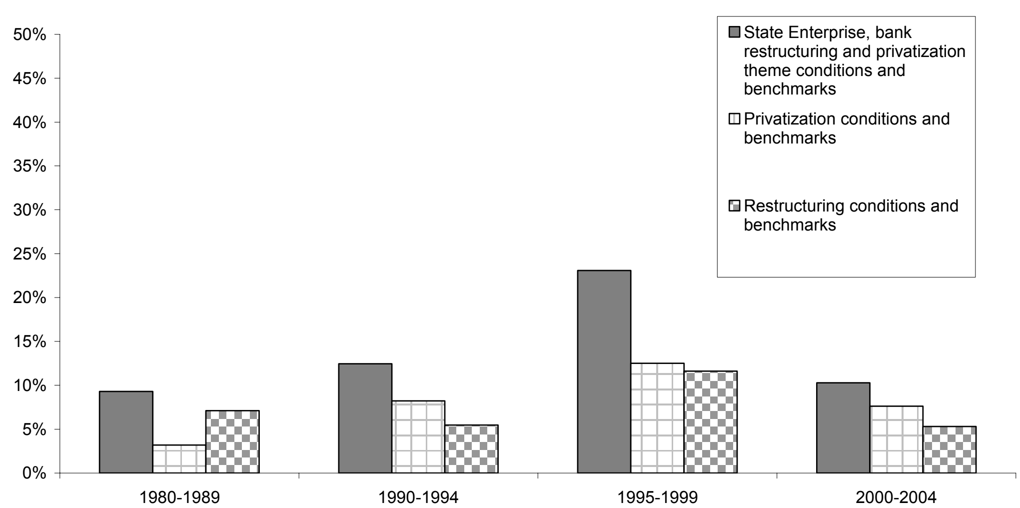
8 See among others, Berthelemy, et al 2004; Estache and Leipziger 2001; and Nellis 1999.
9 Kikeri and Nellis 2004.
10 For an in-depth review of the literature, see Kikeri and Nellis 2004.
11 Estache, et al. 2003.
12 Guash 2004.

impact of privatization on growth. The specific impact of infrastructure privatization is hard to assess since it was often matched by a higher than proportional reduction in public resources in the sector. In Latin America, while the effect of increased private sector participation in infrastructure was indeed associated with faster growth, there is also evidence that the drop in the total resources associated to the sector had a high opportunity cost, in particular in the poorest countries of the region. A recent study conducted for AFR suggests that privatization had, in fact, no statistically significant impact in the Region.[13]

23. ***Public Perceptions.*** Despite mounting empirical evidence on the benefits of privatization (including for the underserved), privatization efforts often arouse dissatisfaction and opposition from civil society and policymakers, who question its benefits, particularly when it is applied in large infrastructure and network industries.[14] This suggests a clear need for wider civil society consultations to inform and guide the design of such reforms and those of the regulatory process.

24. ***Overall Trend.*** After a progressive increase over the 1990s, the relevance of conditionality associated with public enterprise reform (either restructuring or privatization) has returned to levels comparable to those of the 1980s. Disaggregating further, however, shows the changing nature of conditionality, with a progressive increase in importance of privatization as opposed to public enterprise restructuring (see Figure 8). Looking forward, privatization processes are inevitably bound to diminish over time as, in aggregate, governments in most developing countries increasingly reflect the liberalization evolution. Restructuring reforms, however, may see a resurgence in the future as changes in ownership are one-time events and adjustment/restructuring needs are likely to materialize again in the future, for example with regard to contract renegotiation of privatized firms, regulatory frameworks, and tariff structures.

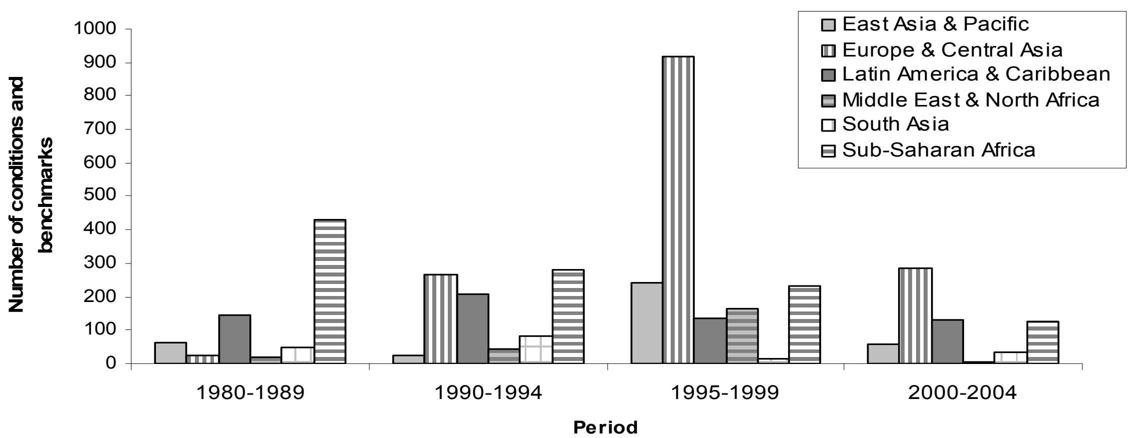
Figure 8. Privatization-Related Conditions and Benchmarks
(% of total conditions and benchmarks)



[13] Estache, Speciale, and Veredas 2005.
[14] For example, Grusky and Fiil-Flynn 2004.

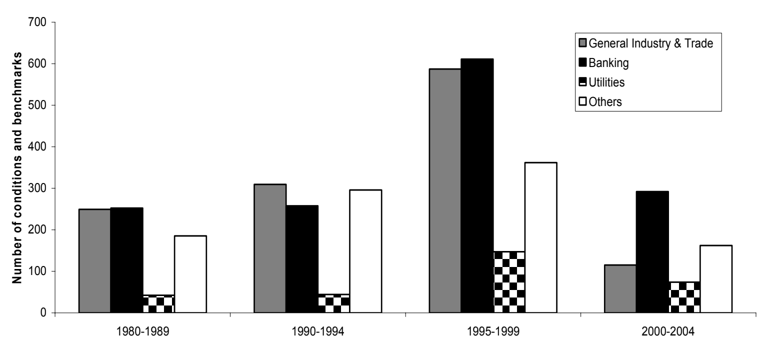
25. ***Regional Trends.*** Policy-based lending conditionality in state enterprise restructuring, banking, and privatization varies across Regions (see Figure 9). Such conditionality has been most common in ECA, with policy-based operations supporting the privatization and restructuring processes taking place during the early transition phase of the mid-1990s and the consequences of the Asian financial crisis of 1997.[15] Operations in LCR have a relatively small but stable share; policy-based operations in AFR have progressively diminished their focus on privatization and restructuring since the beginning of the 1980s. Finally, this type of conditionality is now virtually nonexistent in MNA after growing in importance during the second half of the 1990s.

Figure 9. State Enterprise, Bank Restructuring, and Privatization-Related Conditions and Benchmarks*
(number of total conditions and benchmarks)



26. ***Sectoral Mix.*** General Industry and Banking account for the vast majority of conditions and benchmarks related to state-owned enterprises (SOEs), although their importance has shifted over time, with banking now the key sector of intervention (see Figure 10). In line with the Regional patterns presented above, it is not surprising that these two sectors are also crucial in explaining the peak in conditions and benchmarks in the mid-1990s. Policy-based operations have also increasingly supported this type of reforms in the utility sector, albeit at relatively low levels, while agriculture has progressively diminished in relevance as its share went from 14.3 percent in the 1980-1989 period to 5.3 percent in the 2000-2004 period.

Figure 10. State Enterprise, Bank Restructuring, and Privatization-Related Conditions and Benchmarks*
(number of total conditions and benchmarks)



*Others include: agriculture, government, transportation, other industry.

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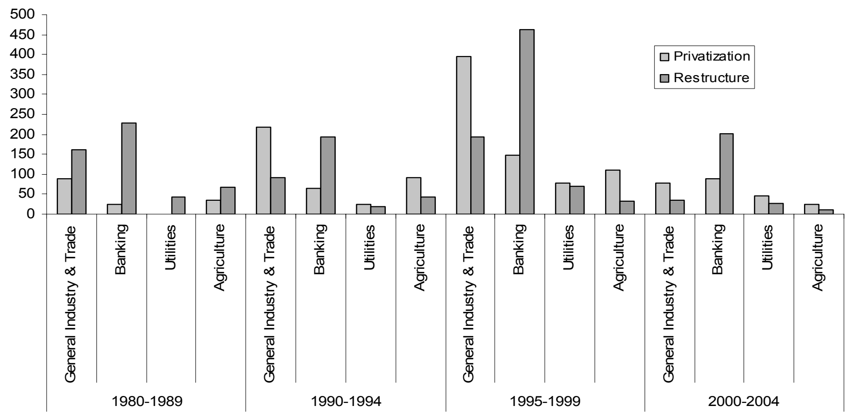
15 World Bank 2004b.

27. ***Focus Mix.*** The relative importance of privatization as opposed to restructuring conditions varies by sector, with restructuring relatively more important in banking and privatization more frequent in utilities and, nowadays, also in general industry (see Figure 11). Reforms of SOEs have not been uniform but have followed different approaches over time and by sector. Accordingly, policy-based operations have incorporated conditions that display the same heterogeneity, as they have adapted to changing circumstances.

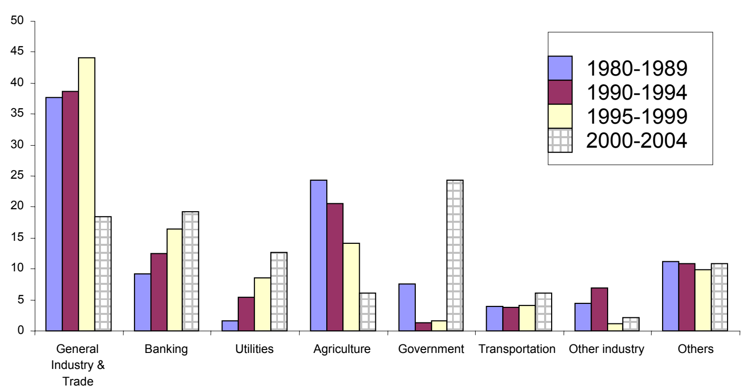
Figure 11. State Enterprise, Bank Restructuring and Privatization-Related Conditions and Benchmarks*
Main Sectors Distribution
(number of total conditions and benchmarks)



* Privatization conditions from this group only

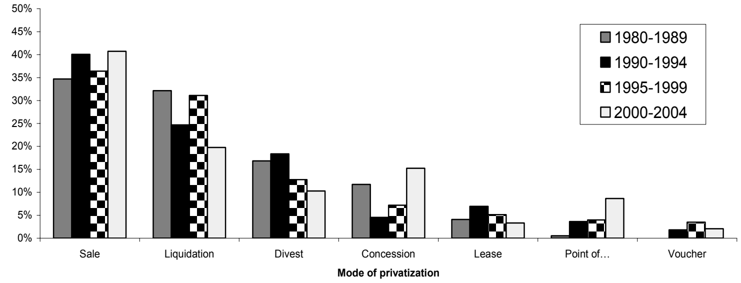
28. ***Privatization Conditions and Benchmarks.*** Focusing on privatization conditions and benchmarks alone, over time policy-based operations have shifted the focus from general industry and agriculture to banking and utilities (see Figure 12). Although conditionality in the banking sector is predominantly associated with restructuring measures, privatization conditions and benchmarks in this sector have increased consistently since the 1980s, likely as a result of an increased reform focus of the financial sector as a whole. Conditions and benchmarks supporting utility sector privatization have also increased consistently since 1980. Nevertheless, general industry remains a key sector of intervention, while privatization in agriculture is no longer as prominent as it was in earlier decades.

Figure 12. Privatization only Conditions and Benchmarks by Sector
(% of total privatization conditions and benchmarks)



29. ***Privatization Modality.*** Over 50 percent of the conditions and benchmarks identify the mode of privatization to be implemented by the reform. While "sales" and "liquidation" are the most frequent privatization modalities (see Figure 13), conditions and benchmarks display the use of several alternative options. Other than sales and liquidation, conditions may support divestiture measures, lease contracts, concessions, voucher schemes, or simply specify that enterprises are brought to the point of sale. Time trends do not show any clear patterns other than the relative decline of divestiture and liquidation measures and the more recent implementation of "point-of-sale" conditions.

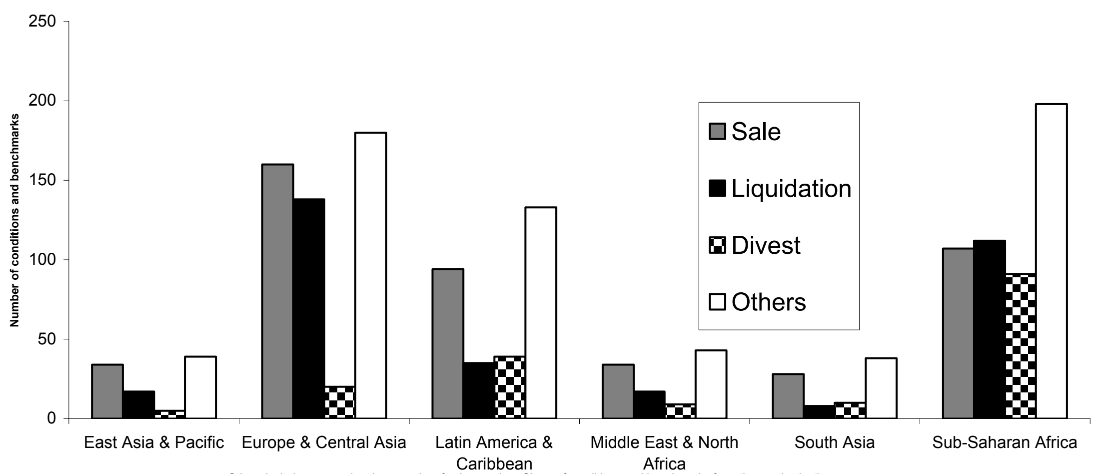
Figure 13 Privatization Modality*



* Share of conditions and benchmarks from those privatization conditions in which a mode of privatization is specified (53% of total privatization conditions and benchmarks)

30. ***Regional Variations.*** Privatization modalities differ by Region (see Figure 14) as they have been adapted to different sector and Regional characteristics. For example, voucher schemes have been prominent in Eastern Europe as the mass privatization reforms of the 1990s were implemented in a political economy context, where this approach was able to generate the necessary support among the relevant stakeholders. In Africa, the recent increase of point-of-sale conditionality is a response to the difficulties often faced by governments when pure sale conditions are contemplated. Often, the relative paucity of buyers places governments in a difficult bargaining position when faced with a sale condition to be met (for example in the utilities sector). Reformulating conditions as point-of-sale when monopsony conditions occur allows governments to proceed with the privatization process without being forced to accept potentially unfair terms.

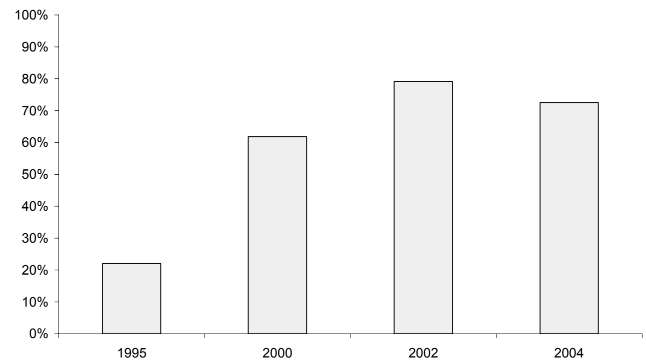
Figure 14. Mode of Privatization by Region, 1980-2004
(number of conditions and benchmarks)



Others include: concession, lease, point of sale, voucher. Share of conditions and benchmarks from those privatization conditions in which a mode of privatization is specified (53% of total privatization conditions and benchmarks)

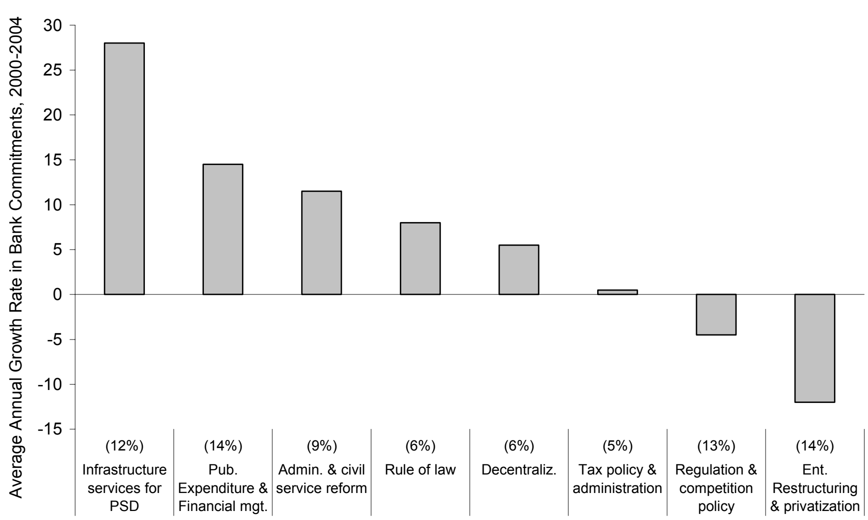
31. ***Complementary Measures.*** Over time, policy-based operations with privatization conditionality have added more complementary measures to support the reform process (see Figure 15). As the debate on privatization reform has highlighted the importance of a series of complementary interventions, conditions and benchmarks have increasingly focused on measures in areas such as regulation, corporate governance, social and environmental safety nets, private sector development, or restructuring. To date, about 70 percent of the conditions and benchmarks on privatization have complementary measures in one or more of these areas. Before 2000, most of these measures centered on restructuring issues. Since then, the focus has shifted toward the consolidation of regulatory frameworks and the development of a business environment. Social safety nets measures are also more prominent, although on a much smaller scale.

Figure 15. Ratio of Accompanying Measures to Privatization Conditions and Benchmarks



32. ***Investment Climate.*** As the World Bank has increased its efforts to improve the investment climate in client countries, operations are now more aligned with this new priority. Data from the Operations Evaluation Department (OED) for the 2000-2004 period show less emphasis on privatization and restructuring measures in Bank commitments and a much stronger focus on measures supportive of private sector development and public sector governance as a whole (see Figure 16).

Figure 16. Privatization and Investment Climate Bank Commitments, 2000-2004



Source: : World Bank Business Warehouse. Quoted from 2004 Annual Review of Development Effectiveness - The Bank's Contributions to Poverty Reduction, OED.
The numbers in brackets on the horizontal axis represent the share of total commitments to investment climate and public sector governance, by thematic area from 2000 to 2004.

C. User Fees

33. The debate around pricing policy in service delivery mirrors issues shaping the discussion of privatization reforms. From a macroeconomic perspective, the budgetary implications associated with large subsidies to cover operational or capital costs associated with the provision of public services have been central to the discussion of the appropriate level of fees charged to consumers. Financial aspects, however, are not the only set of issues informing this debate. Given the public nature of many of the services provided, the discussion on pricing policies has often tried to take into account the public component associated with each service and the associated difficulties in calculating it properly. Efficiency and quality of service considerations have also been central to this debate, as experience has revealed a whole series of deficiencies in the provision of services in many countries. Finally, the design of sustainable pricing structures increasingly takes into account that consumers have different willingness and ability to pay for services.

34. ***Types of Services.*** Pricing policy issues differ by type of service provision as the debate for the power and water sectors, the two key utilities in many countries, is quite different from the discussion in health and education. They are discussed separately below.

1. Power and Water

35. The debate on pricing policy reforms in power and water services has evolved considerably on the basis of experience acquired in many countries. In the early 1990s, there was general support for full cost recovery in the power sector—not only recovery of operation and maintenance but also capital cost—to ensure that power enterprises operated on a fully commercial basis without recourse to the public budget. The financial viability of service providers was expected to help attract the public and private financing needed over time to expand services, including services to poor. Similarly, a financially viable water sector was viewed as a prerequisite for improving access to safe water supply on a sustainable basis.

36. ***Underpricing Variations by Income Level.*** Both in developing and transitional economies, achieving and sustaining cost recovery in both power and water have proven difficult to achieve, though underpricing in water is more prevalent than in electricity. A global survey of electric utilities in 84 countries indicated that in high-income countries, about 83 percent of utilities charge tariffs high enough to cover more than operation and maintenance cost, only 29 percent of upper-middle-income countries and about 25 percent of lower-middle-income countries and low-income countries achieve the same. Another survey covering water utilities in 123 cities worldwide revealed that underpricing of water supply services was still widespread. Even in high-income countries, only 50 percent of water utilities presented tariffs high enough to cover anything more than operation and maintenance costs.[16]

37. ***Phased Measures.*** While support for full cost recovery in electricity and cost recovery of operation and maintenance in water continues to be the long-term objective, it is now recognized that it may take time for tariff adjustments to reflect the cost of service and that these

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[16] Komives, Foster, Halpern, and Wodon 2005.

will have to be implemented gradually. Therefore, it is increasingly important to develop a clear understanding of how to operate during the transition phase. A key element of this strategy is the design of tariff and subsidy policies that provide a social safety net for low-income customers, who may face genuine hardship as tariffs increase toward cost recovery levels.[17]

38. ***Tariff Policy.*** Similar to the debate on privatization issues, the discussions on tariff policy have shifted from the initial attention during the 1990s on the fiscal savings and efficiency gains from commercially operated power and water utilities, to focus more on the effective design of subsidy programs,[18] political economy issues of pricing utility services, regulation and corporate governance, and combining improved service delivery with improved cost recovery.

39. ***Utility Subsidization.*** Utilities are prone to subsidization, at least for some of the residential users in low-income countries and regions. Part of the issue is that their cost structure is characterized by high capital costs with amortization patterns that generate tariff level not always consistent with the ability to pay of the poorest connected users. But this is not the only issue. Indeed, there are a number of pricing strategies that potentially allow a reasonable targeting of these subsidies for energy without damaging the amortization needs. The most effective of these pricing strategies, however, require consumption to be measured. Electricity consumption is usually measured and hence tariffs can be designed to address the needs of the poorest connected users in that sector—and possibly include mark-ups to address the needs of the nonconnected poor as is done commonly in the telecom sector. In water, however, even in many lower and upper-middle-income countries, consumption measurement is still not yet the norm. The challenge is thus larger in water than in electricity. The final set of issues regarding subsidies stem from policy trade-offs associated with pricing decisions. The first is the trade-off between efficiency and equity. In many instances, the reforms of the 1990s favored efficiency, which in turn demanded a subsidy to cater to the needs of the poorest users—in Africa and in LAC, electricity reforms that improved efficiency were actually regressive. In many countries, the historical subsidies were replaced by a cross-subsidy that revealed a trade-off between fiscal concerns and efficiency concerns. The experience of the 1990s in Latin America and increasingly the research being conducted for other regions, including Africa, suggest that the reforms ended up building in sectorwide subsidies rather than subsidies targeted at the users of specific operators. Indeed, many of the reforms entailed some degree of cream skimming as part of the restructuring project. The most commercially attractive segments of the business which, under an integrated public operator, financed the rest of the sector needs were transferred to private operators. Because the tax and other revenue generated by the reforms accrued to the general public sector and no longer to the specific sector that generated the revenue, the existence and the cost of the subsidy to users not served by the commercially viable operators became much more apparent in the public sector accounts.

40. ***Pro-Poor Targeting.*** Subsidies to consumption in utilities are prevalent throughout countries, though their levels vary significantly depending on a country's stage of development. The effective design of subsidy programs is the subject of considerable debate, as there are a host of alternative views on the adequacy of subsidy levels and targeting systems. Central to this

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17 The speed of reform may actually vary depending on the type of consumers. Tariffs may be adjusted more rapidly for industry and commercial enterprises while implemented gradually for households.

18 See, for example, Estache, Foster, and Wodon 2002.

debate is the appropriate mix of tariff and subsidy schemes capable of retaining economic efficiency while ensuring desirable levels of social equity. The available evidence suggests that prevalent utility subsidy schemes based on rising block tariff structures may not be very effective at reaching the poor.[19] Subsidy schemes based on geographic or administrative targeting, although more complex to administer, appear to be more successful at targeting resources toward those most in need.[20]

41. ***Political Economy of Pricing Policy.*** Understanding and managing the political economy of pricing policy has also started to attract considerable attention in the design of policy-based operations focused on utilities. Even if a subsidy system can be technically designed for better targeting, reducing or eliminating subsidies that have been previously available to general consumers has been shown to be politically challenging. Furthermore, the regulatory environment and corporate governance are now central in the debate over adequate pricing structures for utilities. The way markets are structured, the way competition is introduced, and the way regulatory commitments are implemented determine if commercially operated utilities and cost recovery are benefiting consumers, including poor people. The weaker the regulatory structure, the less likely that the concerns of poor people will be accommodated in public policy decisions. There is a need to synchronize pricing and quality improvements so as to avoid transferring inefficiencies and losses to consumers through higher pricing.

2. Health and Education

42. Because policy-based lending conditionality related to health and education fees is almost nonexistent, the issues central to this debate will be treated briefly. To date, there is a significant support for the provision of free education and basic health services, which also informs Bank policy in these sectors. The fiscal implications of such policies in many countries are, however, an area of debate. Concerns are emerging on the consequences of fee removal on the quality of services provided—particularly for certain health provisions—as the lack of alternative funding could result in a decay of the service to the extent that even poor people might prefer to pay fees to access better quality services from private providers.

43. ***Education Services.*** In countries where binding financial constraints force government and/or local communities to impose fees for education services, the discussion revolves around the appropriate design and financing of targeted, demand-side mechanisms to support poor families in sending children to school. These may take the form of targeted subsidies of various forms (stipends, vouchers, bursaries, and so forth), which have often been shown to increase considerably the enrollment rates of poor people.[21]

44. ***Health Services.*** In the health sector for countries unable to fully fund the provision of free basic services, options for financing shape the debate. Alternatives include households contributing premiums to risk-sharing arrangements, such as community financing and other insurance schemes that can protect people from the impoverishing effects of infrequent, but costly illnesses. Under this scenario, governments can subsidize the premiums of poor populations so that financial protection under such insurance arrangements will expand to cover

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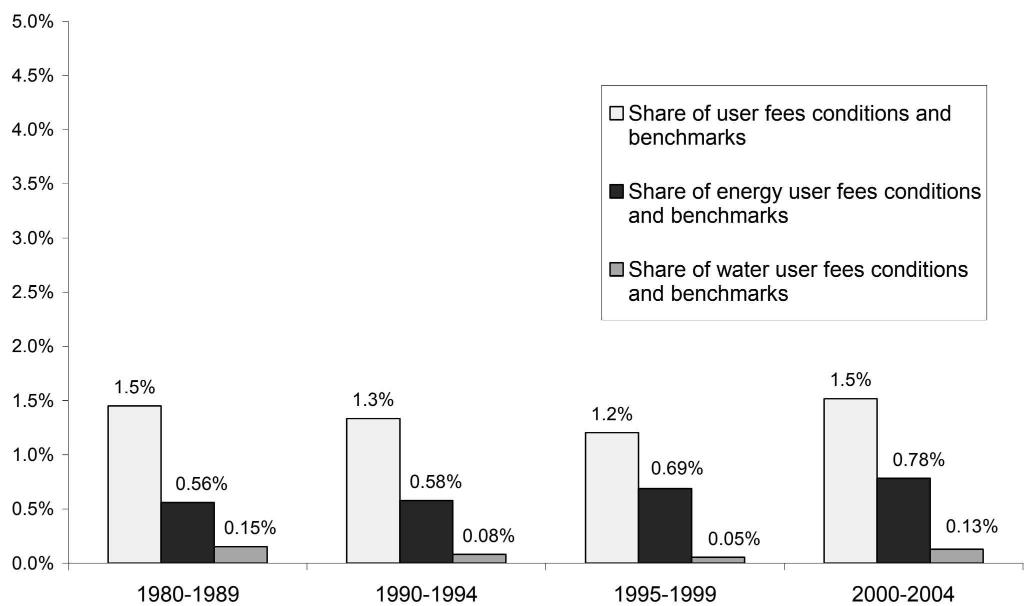
[19] Komives, Foster, Halpern, and Wodon 2005.
[20] Komives, Foster, Halpern, and Wodon 2005.
[21] Kattan and Burnett 2004.

larger segments of their societies. In the absence of such insurance arrangements, in very low-income communities where the government's resources are extremely limited, well-designed and -implemented user fees can mobilize additional resources from better-off groups that can, in turn, be used to improve services for poorer groups. Such cost-sharing schemes can play a critical role in helping ensure that essential services are available.

3. Review of Trends

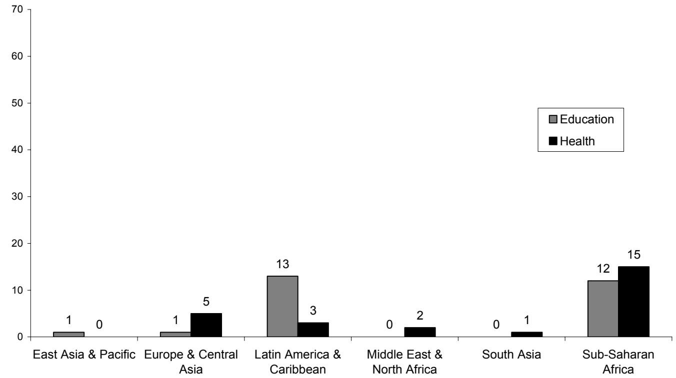
45. Conditions and benchmarks associated with user fees are only 1.3 percent of the total, and the percentage has remained stable over time (see Figure 17). User fee conditions and benchmarks are a minor component in all sectors, with their greatest use associated with reforms in the energy sector.

Figure 17. User Fees Conditions and Benchmarks
(% of total conditions and benchmarks per period)



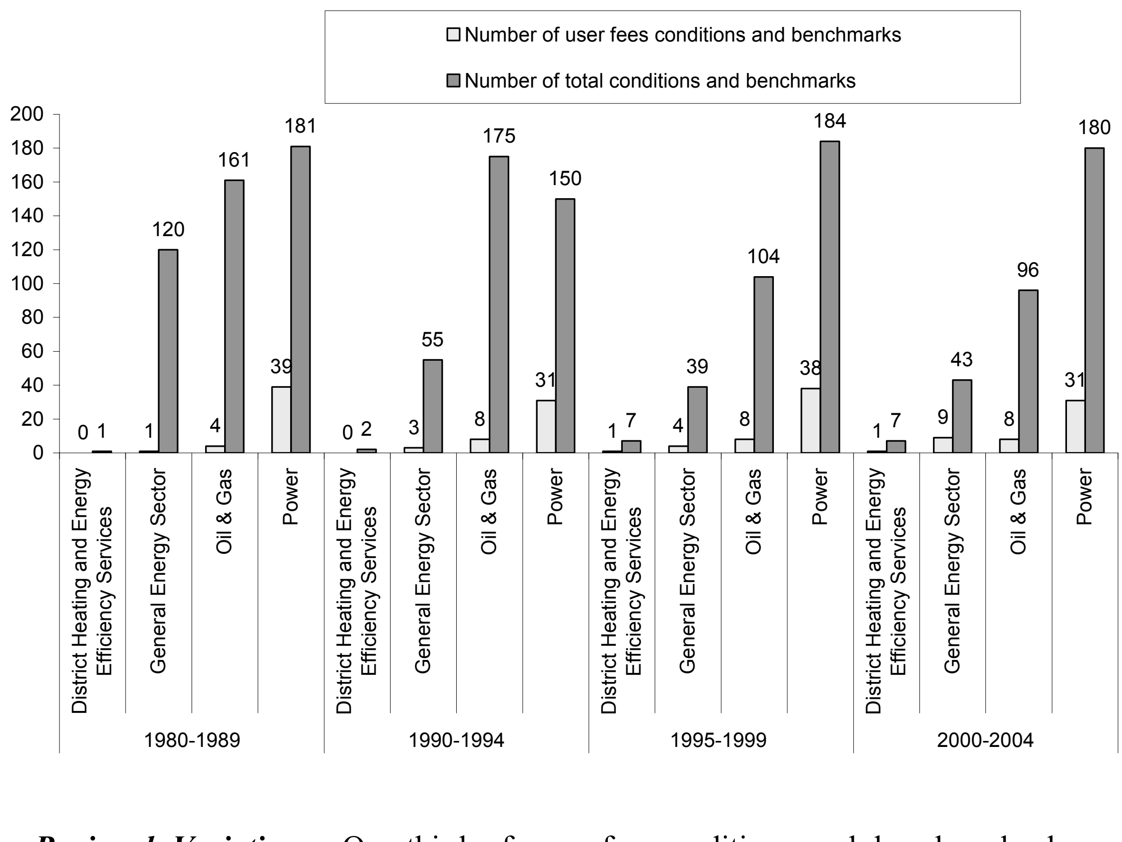
46. ***Basic Health and Education.*** User fee conditions and benchmarks on basic education and health are almost nonexistent in policy-based operations (see Figure 18). As the current debate on the free provision of basic health and education services resonates also within the World Bank, it is not surprising that the number of conditions in these sectors is negligible. When present, conditionality may actually call for fee removal or for the design of targeted schemes to support access for the poor.

Figure 18. Education and Health User Fees, 1980-2004
(number of conditions and benchmarks out of 28,773 conditions and benchmarks)



47. ***Energy Sector.*** Within the energy sector, the conditions and benchmarks associated with user fees are concentrated almost exclusively in power. Policy-based operations in the energy sector can be further disaggregated into operations focusing on district heating reforms, general energy sector, and the power sector reform. The few conditions and benchmarks associated with user fees can be found mostly in the power sector (see Figure 19).

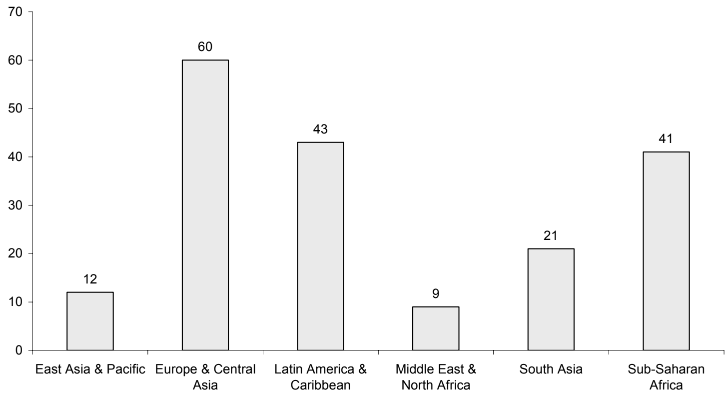
Figure 19. Number of User Fee Conditions and Benchmarks on Energy and Total Number of Conditions and Benchmarks



48. ***Regional Variation.*** One-third of user fee conditions and benchmarks have been concentrated in ECA, followed by LCR and AFR (see Figure 20). Following the privatization processes in Eastern Europe and Central Asia, which encompassed reforms aimed at the commercialization of the power sector, policy-based operations have at times supported the

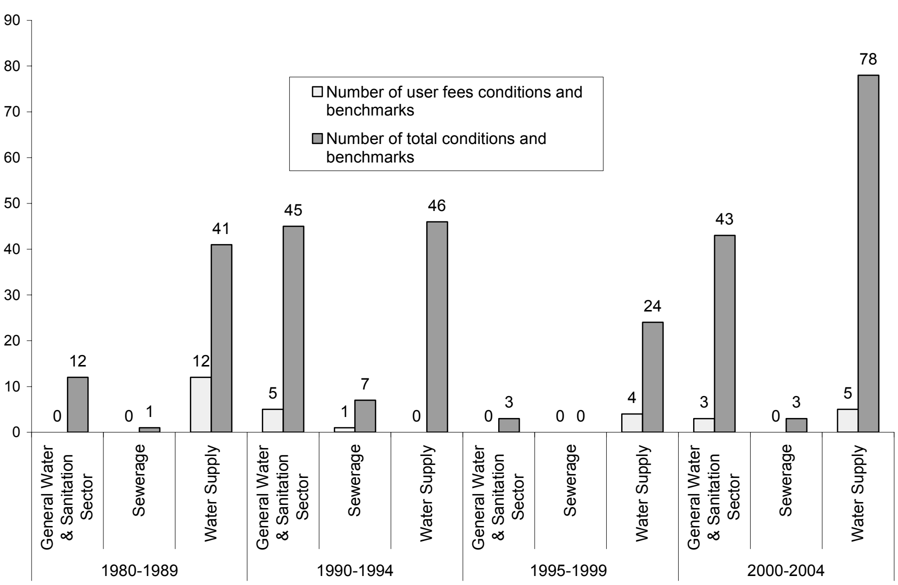
implementation of new tariff structures designed to foster the financial stability of the service provided. Operations of this kind have also taken place in LCR and AFR.

Figure 20. Energy User Fee Conditions and Benchmarks, 1980-2004
(number of conditions and benchmarks)



49. ***Water Sector.*** Policy-based operations with user fee conditions and benchmarks in the water sector are very limited (see Figure 21), with a focus primarily on reforms of the provision of water services to the population. From 1980 through 2004, about half of such operations have been in AFR.

Figure 21. Number of User Fee Conditions and Benchmarks on Water and Sanitation and Total Number of Conditions and Benchmarks



50. ***Complementary Measures.*** Similar to privatization, complementary measures are associated with the presence of user fee conditionality in policy-based lending. For health and education, such measures can range from fostering public expenditure to improve the quality of services (such as increased funding for textbook and materials for students), to establishing a health fund to provide coverage for basic health care to poor people, or establishing a list of

underserved health districts to benefit from priority investments. For the electricity and water sectors, tariff changes may be supported by the introduction of compensatory mechanisms for poor people. Similarly, a condition on subsidy reduction may be accompanied by enhanced targeting of social assistance. Establishing an independent regulatory institution is another accompanying feature to ensure transparent regulation of the utility sector.

D. Trade

51. Arguments on trade policy have a long and controversial history, alternating between the relative benefits of economies open to trade and capital flows and the potential benefits of industrialization through import substitutions and infant industry arguments.

52. ***Overview.*** By the 1980s, many developing economies were operating under fairly closed systems in trade of goods and capital, combining tariffs and quantity restrictions as well as control on the availability of foreign exchange. In many cases, the overall system of control exceeded even what the defenders of protection would consider sufficient or beneficial. This approach to development gave rise to entrenched interests that defended the status quo and the source of their privileges. However, slowdowns in the rate of economic growth, failure to generate employment opportunities for growing populations, mounting macroeconomic difficulties (inflation), and difficulties with managing the external debt brought many of these economies to the point of crisis and gave rise to a process of trade and then capital account liberalization.

53. ***Reforms and Remaining Issues.*** A process was set in motion of dismantling the controls on trade of goods and services, removing quantitative restrictions, and lowering and rationalizing tariff systems. A significant process of liberalization has taken place and economies are far more open today, although the levels of tariff dispersion and nontariff barriers continue to be high in some parts of the world. Many countries have approached these reforms within the context of the World Trade Organization (WTO), some also have been actively been engaged in regional trade agreements or negotiating free trade agreements on a bilateral basis. The recent Doha trade WTO round is intended to open the door for even freer trade, but the access of agriculture products from developing countries to developed countries and reduction of the substantive subsidies developed countries provide to farming activities continue to be an unresolved issue.

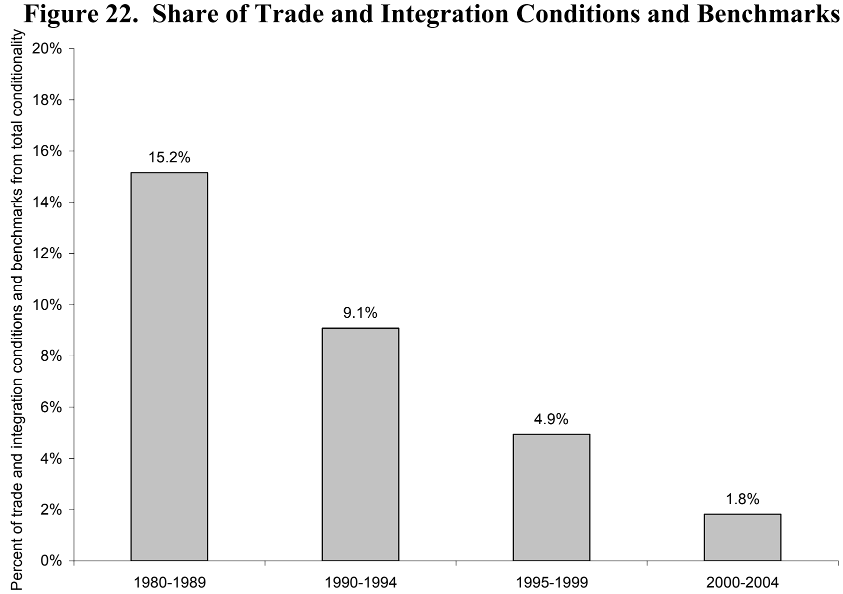
54. ***Bank Role.*** The Bank's role in trade reform has paralleled the worldwide trends. During the 1980s, around 15 percent of conditions and benchmarks dealt with trade issues, and referred primarily to the elimination of quantitative restrictions, simplification of tariff structures, removal of nontrade barriers, the freeing up of foreign exchange markets, elimination of price distortions, and movement toward market-based exchange rates. The emphasis was on getting the relative prices right and on helping countries with fiscal adjustment. As the agenda of country trade reform narrowed and shrunk and the Bank focused more on institutional determinants of growth, Bank conditions and benchmarks have declined to the point that only 1.8 percent of total conditions and benchmarks cover trade issues. At the same time, the focus of conditionality has shifted. The emphasis now is on improving the underlying conditions for trade by removing the behind-the-border barriers to trade.

55. ***Summary.*** There are two main messages that emerge from this review: (a) while trade was an important component of the Bank's policy-based agenda, the frequency of trade conditions and benchmarks has gradually declined to the point that it is no longer a relevant component, and (b) the emphasis of the minimal remaining conditions and benchmarks has shifted to trade facilitation, focusing on issues such as certification, improving quality, and removing internal restrictions to external trade. To some extent, the agenda on trade has merged with the agenda on improving the investment climate. The Bank also continues to be involved in trade issues through analytic work as background to gain a better understanding of growth prospects.

56. ***Data for a Review of Trends.*** The remaining paragraphs take stock of the how the patterns of trade conditions and benchmarks have evolved since the 1980s. The analysis is based on the information available from the set of all policy-based operations, plus a more in-depth review on a sample of these operations prepared by OED, which allows a more detailed analysis of both trends and the content of the conditionality.

57. ***Volume.*** The presence of trade conditions and benchmarks in Bank operations has declined over time in absolute number and as a percentage of total. During 1980-1989, 15.2 percent of all conditions and benchmarks concerned trade issues, while the comparable figure for 2000-2004 was only 1.8 percent (see Figure 22). Exhibiting a similar trend, the absolute number of trade-related conditions and benchmarks dropped.

Figure 22. Share of Trade and Integration Conditions and Benchmarks



58. ***Regional Picture.*** The presence of trade conditions and benchmarks has dropped in all Regions (see Table 1), with the greatest drop in the Middle East and North Africa Region (from 67.6 percent during 1980-1984 to zero at present). The drop has also been considerable in the Latin America and the Caribbean Region (from 41.9 percent during 1980-1984 to 1.9 percent during 2000-2004). In the 2000-2004 period, the largest share of trade conditions and benchmarks is found in East Asia and the Pacific (EAP), at 6.8 percent. Interestingly, trade conditions and benchmarks have not been as prevalent in Europe and Central Asia, where, when the period from 1980 to 2004 is considered as a whole, the share of trade conditions and benchmarks has only been 4.1 percent. This illustrates critical differences in initial conditions as well as how the countries (and Regions) have approached trade liberalization. For instance, trade liberalization was high on the agenda of Latin American countries in the 1980s and early 1990s, as the countries were making a

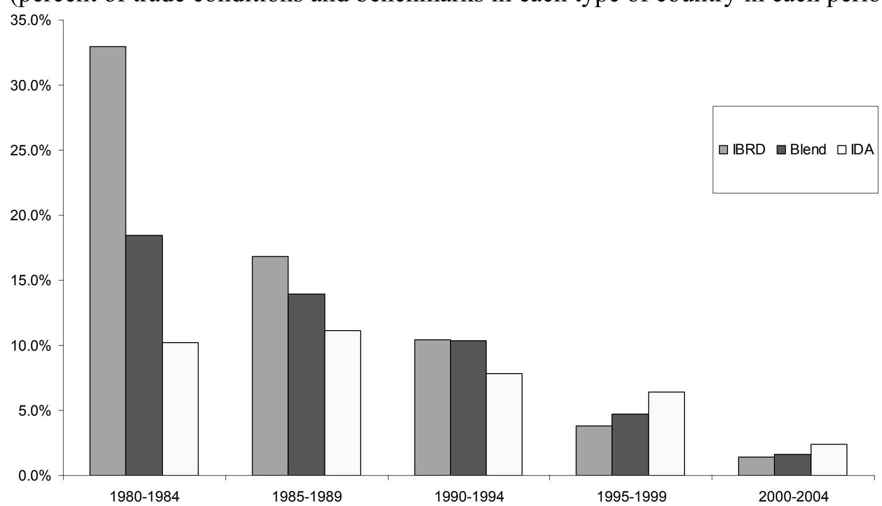
transition from high levels of protection to fairly open economies, often anchored on free trade agreements with large developed economies, as was the case of Mexico with NAFTA.

Table 1. Share of Trade Conditions and Benchmarks per Region (%)

	1980-1984	*1985-1989*	*1990-1994*	*1995-1999*	*2000-2004*
East Asia & Pacific	28.3	10.9	9.1	3.3	6.8
Europe & Central Asia	18.8	8.6	5.3	4.1	0.9
Latin America & Caribbean	41.4	21.3	11.9	1.3	1.9
Middle East & North Africa	67.6	10.1	12.3	8.5	0.0
South Asia	7.9	11.6	12.1	0.0	2.4
Sub-Saharan Africa	13.0	12.1	8.0	8.3	2.0
Overall	21.4	13.7	9.1	4.9	1.8

59. ***IBRD, Blend, and IDA Countries.*** Trade conditions and benchmarks have declined for IBRD, blend, and IDA countries (see Figure 23). During the early 1980s, trade conditionality was particularly high in IBRD countries (almost 35 percent of total conditions and benchmarks), largely reflecting its concentration in Latin America and the Middle East, where countries are mostly IBRD borrowers. In the same period, the incidence of trade conditions and benchmarks in IDA countries was only 10 percent. Now, however, the incidence is larger in IDA countries (and relates to trade facilitation issues), although in all of them it is low.

Figure 23. Share of Trade Conditions and Benchmarks
(percent of trade conditions and benchmarks in each type of country in each period)



60. ***Conditions and Benchmarks per Operation.*** The number of trade-related conditions and benchmarks per operation has also declined (see Table 2). The number of Bank operations containing trade conditionality and the absolute number of trade conditions and benchmarks both peaked during 1985-1989. Thereafter, the number of conditions and benchmarks has come down faster than the number of operations, and consequently the number of trade conditions and benchmarks per operation has fallen. The drop has been from 9 conditions and benchmarks per loan in 1985-1989 to 2.7 in 2000-2004. This trend reflects emerging Bank policy to simplify and focus conditionality. More detail on the number of legally binding conditions is provided by a sample selected from operations that had 20 percent or more trade-related components and that covered 81 operations of a total of 119 operations. This sample has been prepared by OED as part of a review of Bank work on trade. The sample (see Figure 24) shows that conditions have

fallen since 1987 (albeit with a peak, at 15 conditions per loan, in 1993), to 3.7 during this decade. Even after factoring in indicative benchmarks that are included in a loan matrix, the overall trend does not change.[22]

Table 2. Average Number of Conditions and Benchmarks per Loan

	Operations	*Conditions and Benchmarks*	*Average number of conditions and benchmarks per loan*
1980-1984	41	317	7.7
1985-1989	97	872	9.0
1990-1994	98	661	6.7
1995-1999	72	365	5.1
2000-2004	42	114	2.7

Figure 24. Evolution of Trade Conditions and Benchmarks
(average number of conditions and benchmarks per loan)

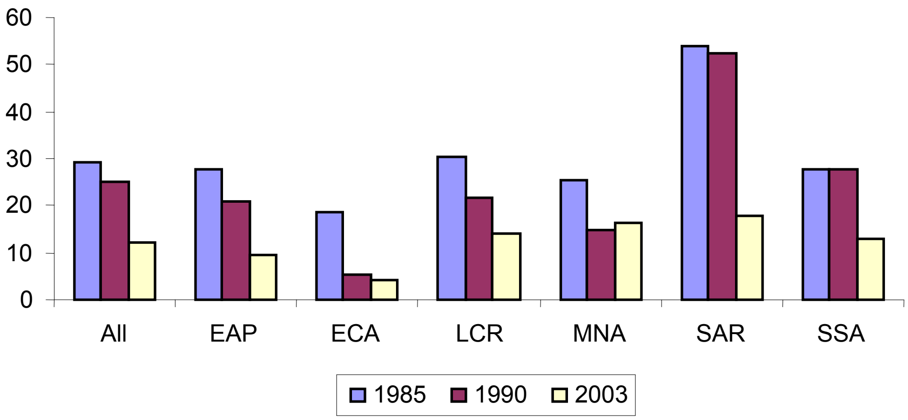
61. ***Trend of Core Trade Operations.*** There has also been a decline in what can be called core trade operations—those operations that have more than 50 percent focus on trade. During the 1980s, one-fourth of all policy-based operations in the sample had 50 percent or more focus on trade, and covered 25 countries. Since 2000, core trade operations are a negligible portion of policy-based lending. The OED sample shows that the level of trade conditionality was often associated with the existing level of protection and trade distortion. By the 1980s, many developing countries had highly distorted trade regimes. The countries in the OED sample, prior to World Bank interventions, had average tariff levels on goods above 29 percent and nontariff frequency ratios above 50 percent. Moreover, these countries often applied restrictions on the availability of foreign exchange.

62. ***Protection Levels across Regions.*** Tariff levels for all countries in all Regions in the OED sample have fallen considerably; with the greatest declines in South Asia and Latin America (see Figure 25). Average import tariffs fell from 30.6 percent in the year preceding reforms to 17. 2 percent two years later. In 2003, import tariffs averaged 12.8 percent. The fall

22 Conditionality refers to the set of explicit conditions upon which the Bank disburses under development policy lending, and which are listed as legal conditions in a Loan Agreement. Loan matrices also include nonbinding informal policy agreements, with indicative benchmarks; although these lack legal standing, clients often view them as part of Bank conditionality.

in protection was not matched by a commensurate or unequivocal fall in dispersion as manipulations in the tariff regimes led to increased dispersion in some Regions. The coverage of nontariff barriers also fell significantly, but the reforms in this area were less dramatic than those targeting import tariffs. Two Regions in particular—SAR and MNA—continued to exhibit relatively high nontariff barrier coverage. In general, however, by 2003 the agenda of country trade reform had significantly narrowed and shrunk, resulting in fewer opportunities and rationale for trade conditionality.

Figure 25. Average Unweighted Tariffs, 1985-2003

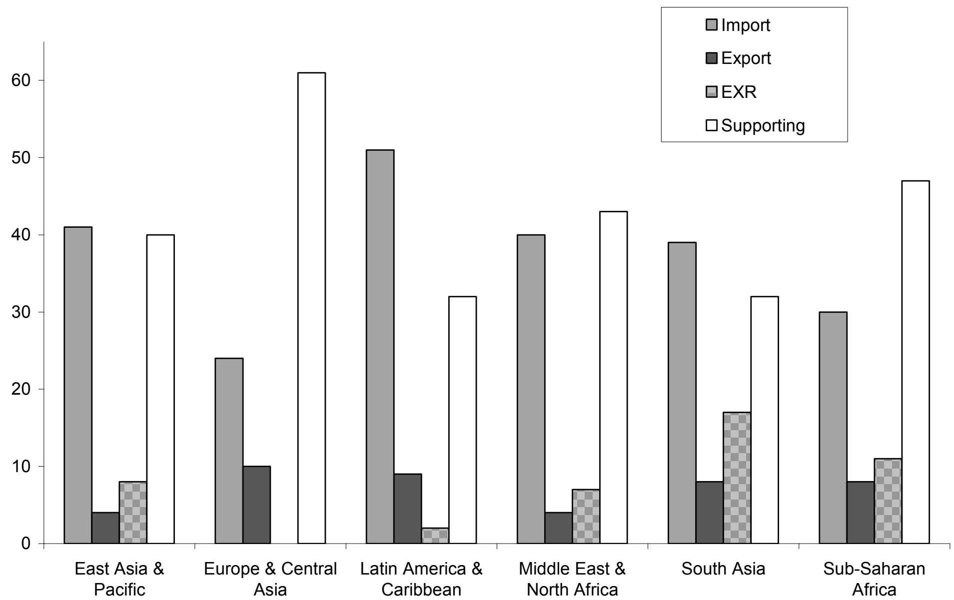


63. ***Shift of Focus.*** Most importantly, a shift has taken place over time in the nature of trade conditionality. Initially the emphasis was on removing quantitative restrictions and nontrade barriers, freeing up foreign exchange markets, and moving to market-determined exchange rates. This was followed by an emphasis on reduction of trade tariffs and simplification. Currently, the emphasis is on supporting policies, which means a focus on removing behind-the-border constraints on trade—customs, standards, and so forth. Here the trade and the investment climate agendas have converged.

64. ***Regional Variations.*** Trade conditions and benchmarks in the sample centered mostly on reducing import protection or on supporting policies.[23] In Latin America, the overwhelming focus has been on imports (see Figure 26). In South East Asia, too, import regime reform has absorbed the greatest attention. In ECA, AFR, and, to a lesser extent, MNA, the emphasis has been on supporting measures. (ECA is a mild outlier. It has the fewest trade conditions and benchmarks of all Regions, and most of that refers to supporting measures, reflecting the fact ECA countries, for the most part, moved to open trade and reduce tariffs early. In fact, the former socialist countries were fairly open and highly integrated within their own block, and no significant protectionist policies emerged after the collapse of socialism.)

[23] The category of other supporting policies is a broad one that includes supply-side policies. Specific examples include trade or investment promotion, competition policy, trade financing and guarantees, and marketing and price distortions.

Figure 26. Focus of Trade Conditions and Benchmarks, 1987-2003
(number of conditions and benchmarks)



65. ***WTO.*** As the World Bank and other international financial institutions reduce their participation in trade issues, the WTO has become the forum for trade issues. The Bank continues to support analytic work in trade, often related to identifying internal barriers to trade or to assessing divergence from optimal patterns of diversification. Many developing and transition economies continue to concentrate exports on a few items and hence are highly exposed to the uncertainty of the international markets. The priority is then given to finding ways in which to improve the investment climate and the capacity to compete.

III. CONCLUSION

66. This note has taken stock of the evolution and salient features of Bank conditionality in four critical areas—public sector governance, privatization, user fees, and international trade—since 1980. Perhaps the most important trend is the increasing emphasis on institutional development, through support for improving expenditure and budgetary practices, upgrading of civil services and public administration, putting in place regulation of natural monopolies, lowering the burden of regulatory compliance on business, and removing internal barriers to facilitate access to external markets. There is also increased attention on how public policy affects poor people and an emphasis on designing mechanisms that enable structural change to occur without disadvantaging poor people.

67. ***Conditionality's Responsiveness.*** The analysis also shows, not surprisingly, that conditionality responds to regional and income-level characteristics. For instance, privatization increased in importance as a source of conditionality with the wave of change in Eastern Europe and Central Asia during the decade of the 1990s; banking sector reform gained prominence after the Asian financial crises; trade reform was prominent in the late 1980s and early 1990s in Latin America, as countries moved to remove restrictions to international trade; and the emphasis on

building up public sector governance and overall institutional capacity is more prominent in poorer (IDA) countries.

68. ***Shifts in Agenda.*** The analysis also shows that some agendas (including trade and user fees) have been exhausted as areas of conditionality in policy-based operations. In the case of trade, the World Trade Organization has become the main forum for discussion and agreements. In user fees, tariff policy in areas of natural monopolies has increasingly become as much linked with regulation and access issues as with financial sustainability. In education and health, there is agreement that basic services should be broadly available, including to poor people, and attention centers on affordability of these strategies, especially in lower-income countries.

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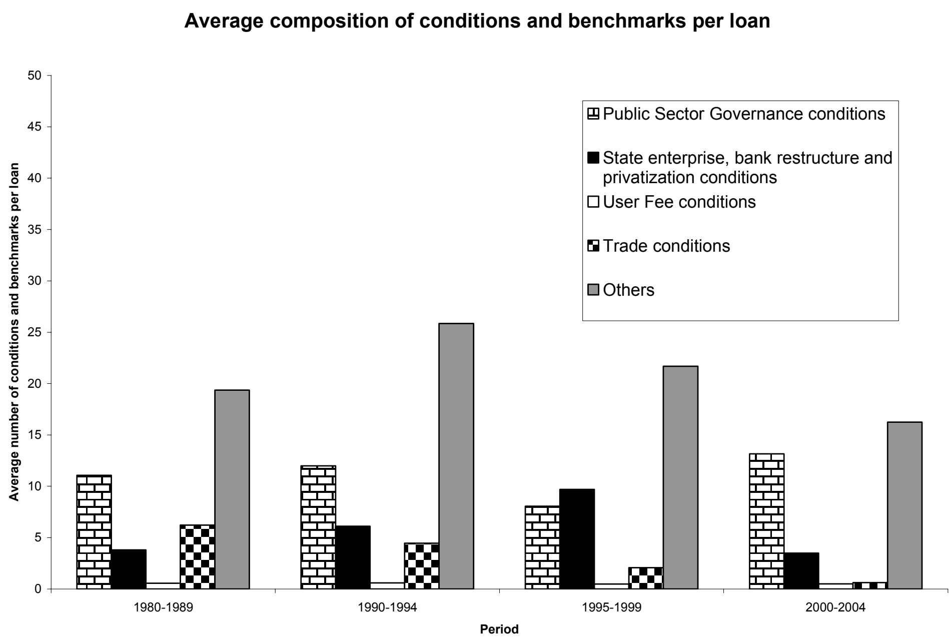
MAIN TABLES COMPUTED ON ONLY LEGALLY BINDING CONDITIONS

Figure A-1



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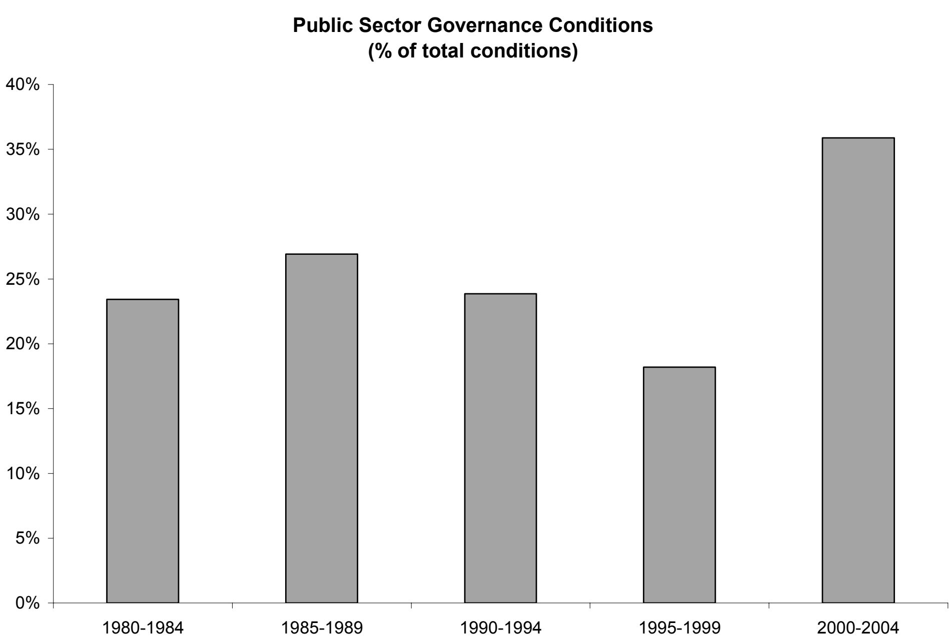

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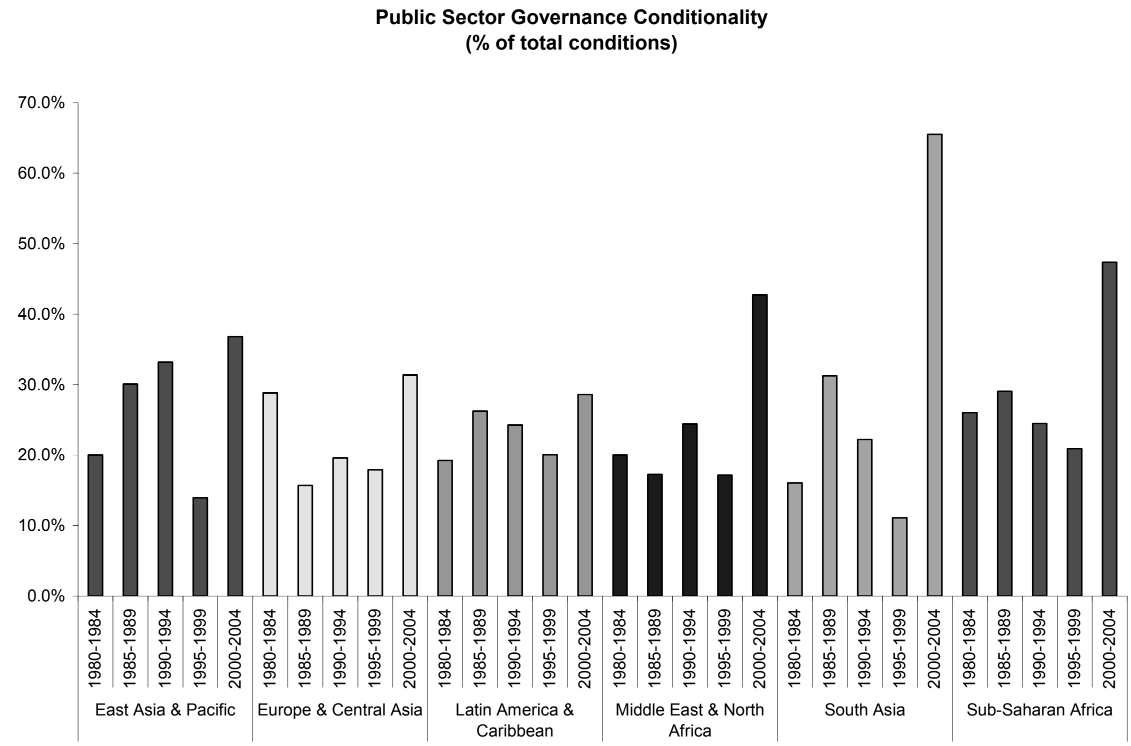

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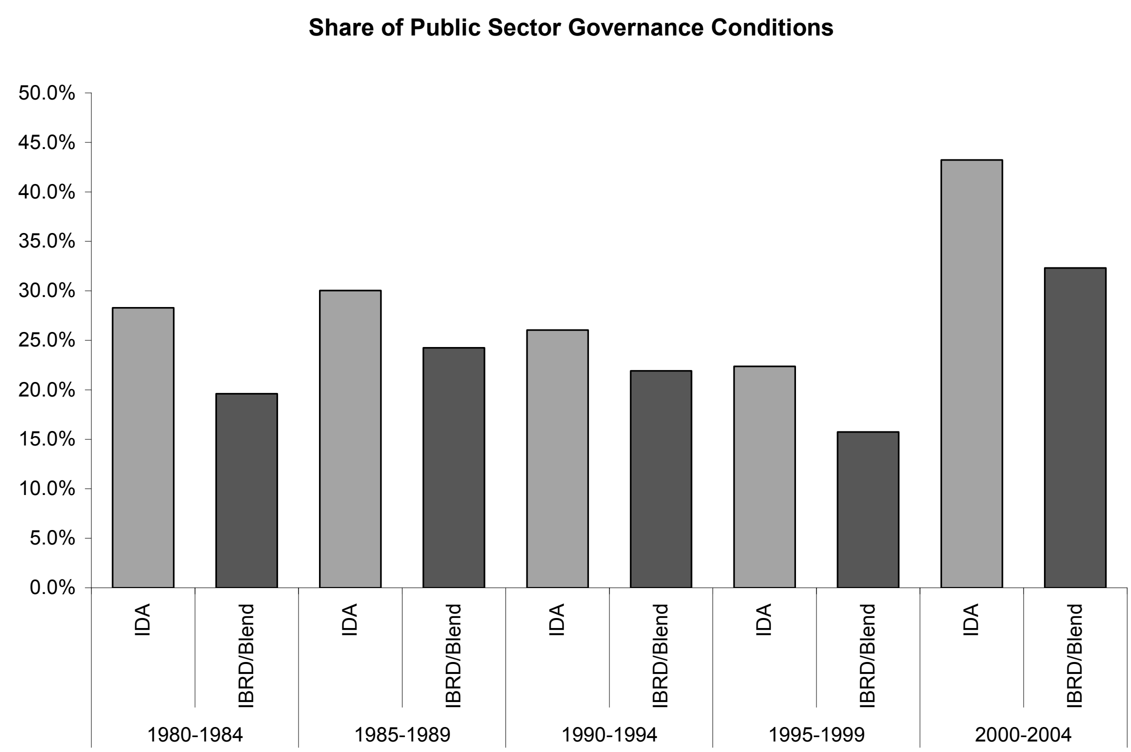

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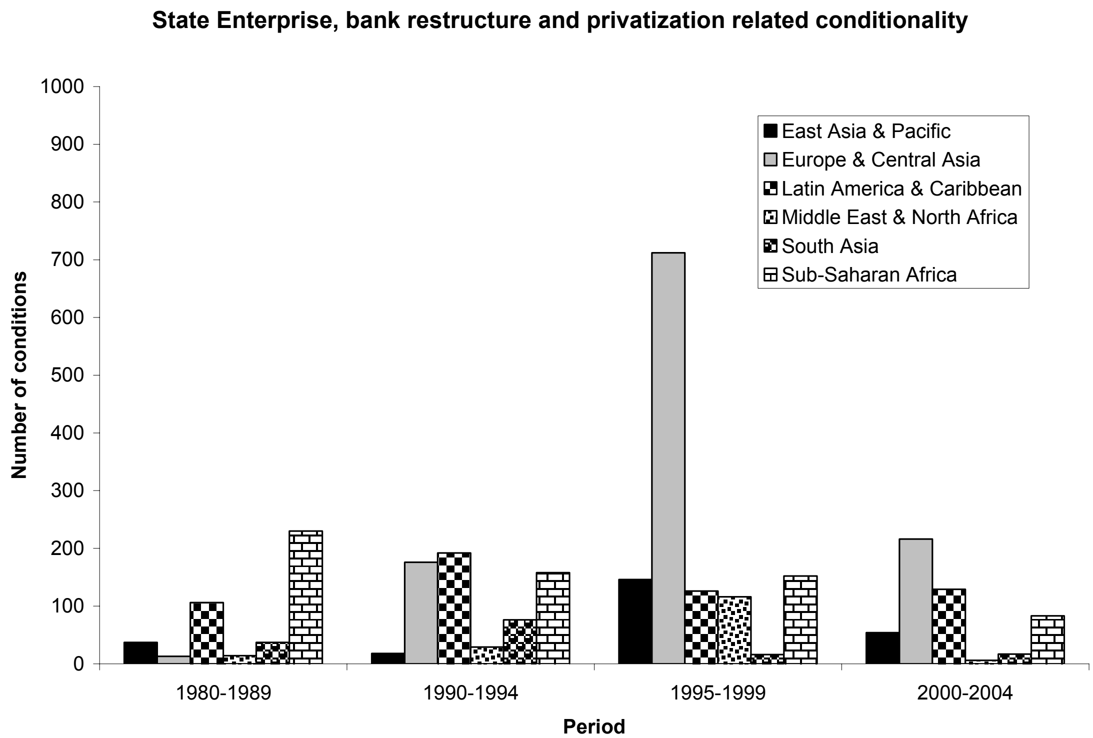

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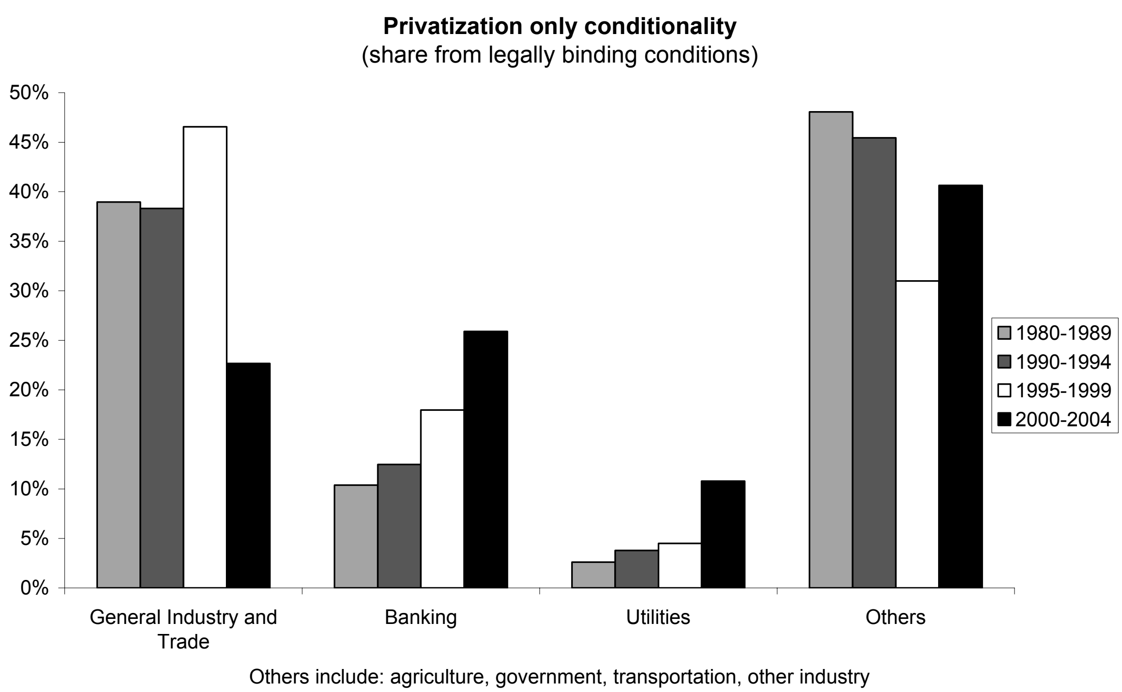

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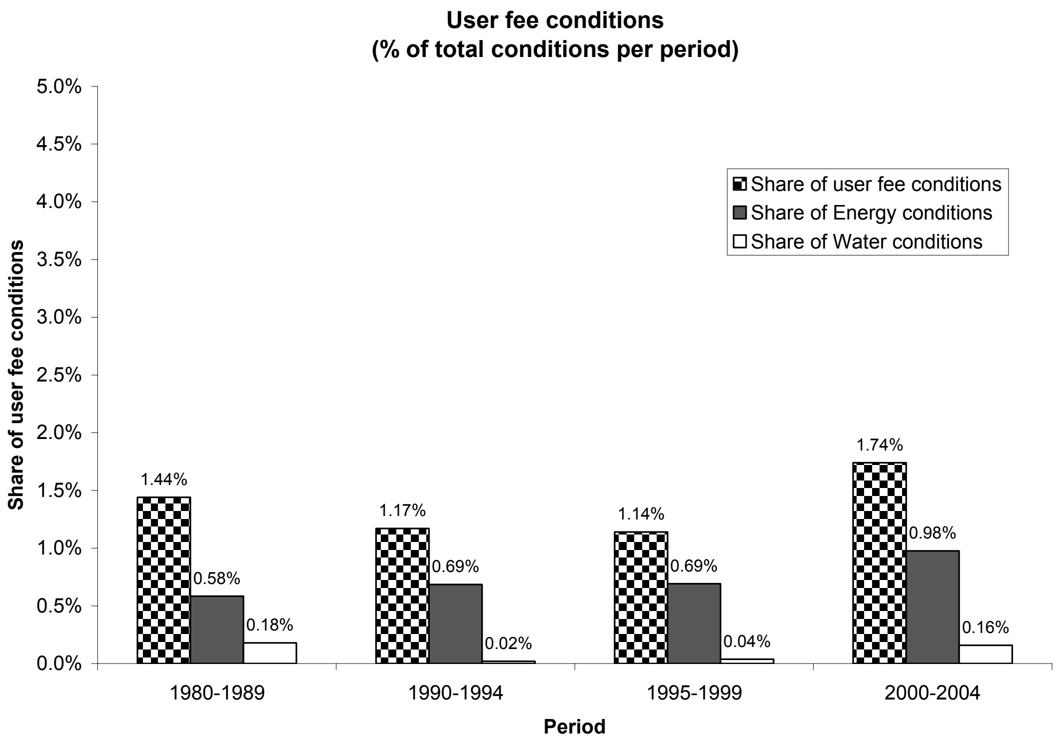

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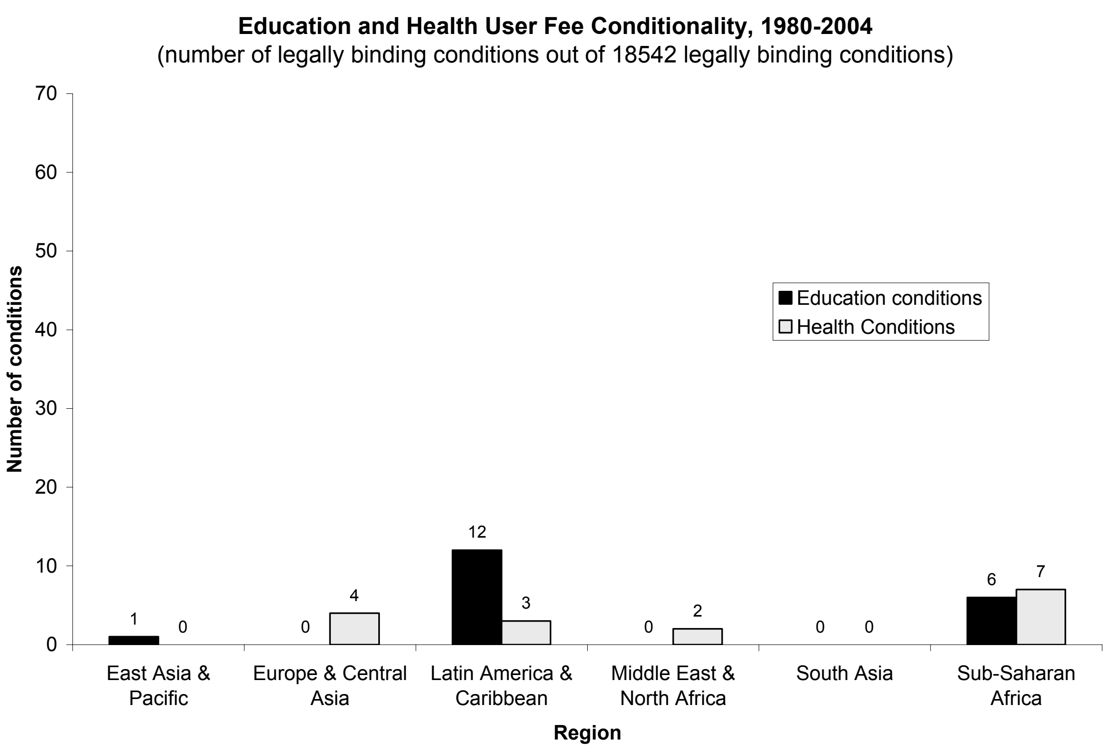

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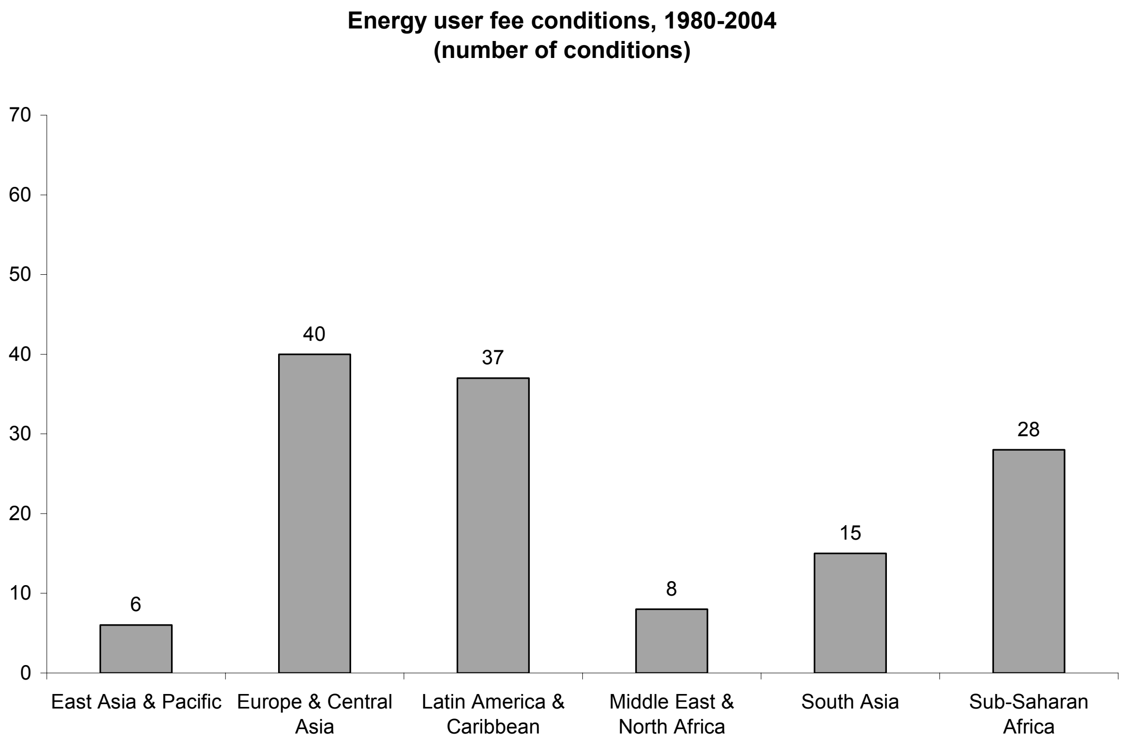
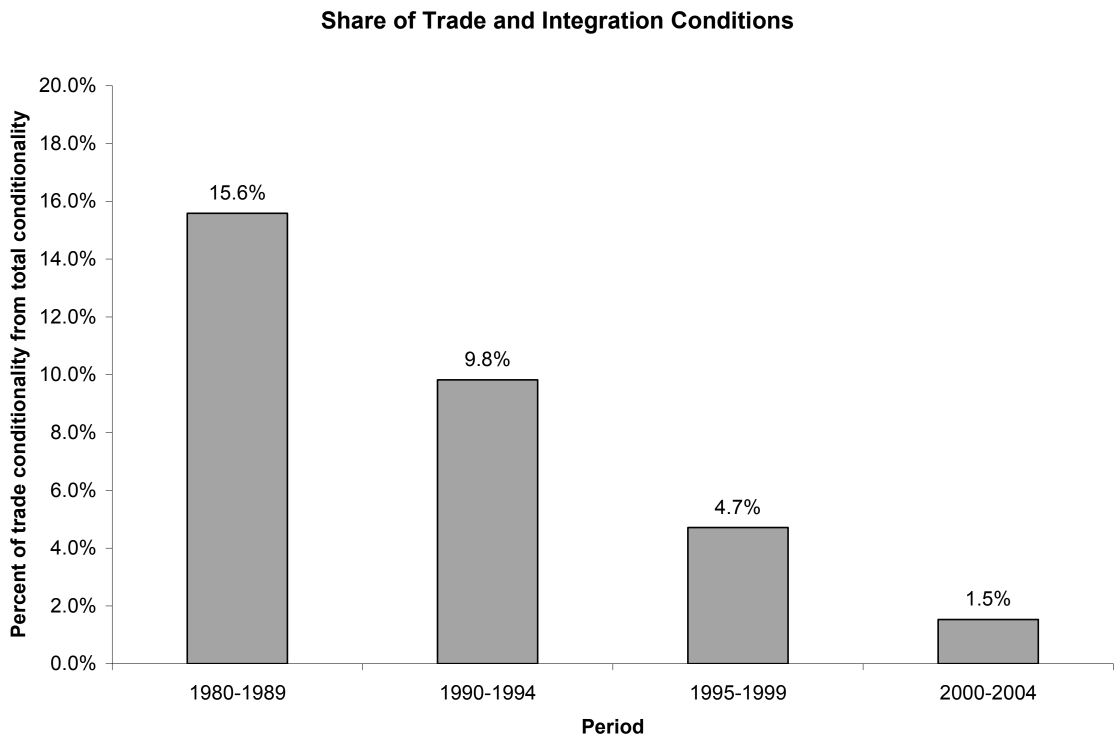


Table A–1

Share of Trade Conditions per Region

	1980-1984	1985-1989	1990-1994	1995-1999	2000-2004
East Asia & Pacific	37.8%	15.2%	7.8%	3.7%	6.2%
Europe & Central Asia	22.5%	3.9%	5.1%	3.9%	0.4%
Latin America & Caribbean	39.2%	19.0%	12.7%	1.1%	1.4%
Middle East & North Africa	66.7%	11.3%	13.8%	8.5%	0.0%
South Asia	6.2%	12.1%	12.6%	0.0%	1.0%
Sub-Saharan Africa	11.5%	13.7%	8.1%	8.5%	2.3%
Overall	21.0%	14.6%	9.8%	4.7%	1.5%

Figure A-22



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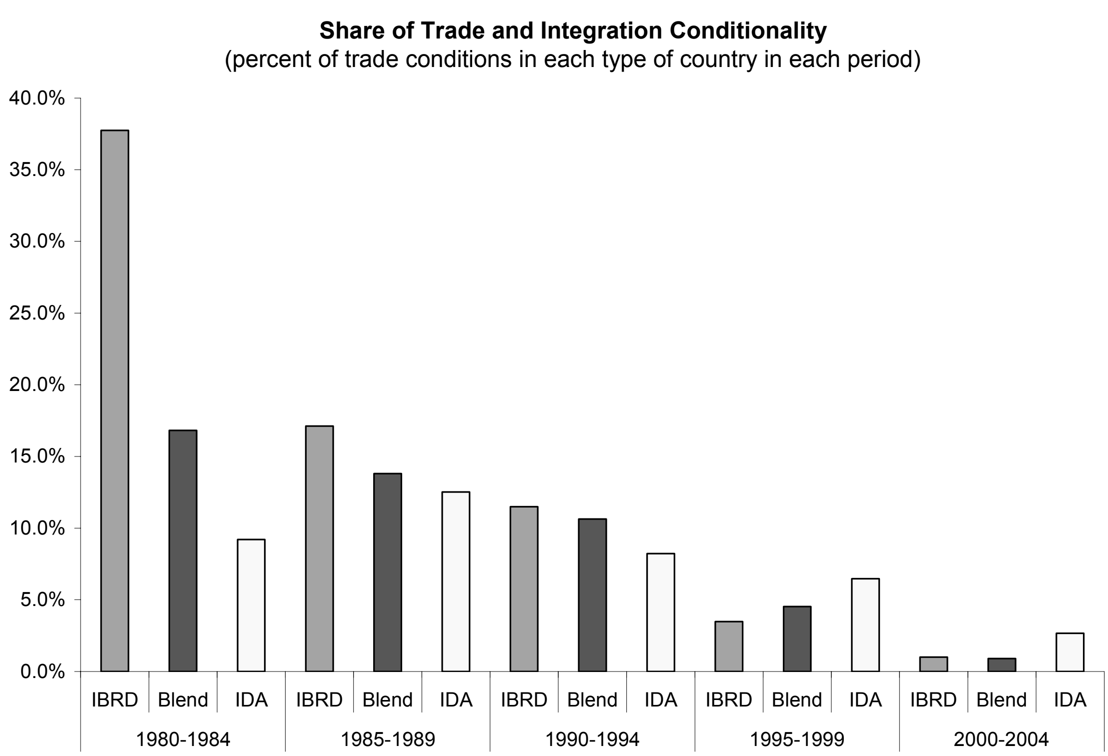

REVIEW OF WORLD BANK CONDITIONALITY
BACKGROUND PAPER 5

THE THEORY AND PRACTICE OF CONDITIONALITY: A LITERATURE REVIEW

DEVELOPMENT ECONOMICS
WORLD BANK

THE THEORY AND PRACTICE OF CONDITIONALITY: A LITERATURE REVIEW

CONTENTS

ACKNOWLEDGMENTS

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The Theory and Practice of Conditionality: A Literature Review

Executive Summary

1. This paper reviews the theoretical and empirical literature on policy-based conditionality drawing on the work carried out by the Bank itself and on academic publications. The paper presents the analytic frameworks on policy conditionality proposed in the literature and assesses their usefulness. Section I introduces the topic. Section II discusses the rationale for conditionality. Section III presents an overview of the existing literature, particularly some of the work carried out by the Bank itself. Section IV focuses on traditional conditionality and identifies the factors driving the effectiveness of conditionality. Section V reviews the theoretical frameworks that have been proposed in the academic literature to conceptualize conditionality. Section VI examines how the Bank has internalized the findings from the literature and adjusted its policies to improve its practice of conditionality. Section VII summarizes findings and considers the alternatives to conditionality.

2. With conditionality, the donor provides incentives to the borrowing government for the implementation of policies that would improve the welfare of its citizens. There are three main rationales for conditionality identified in the literature. First, the recipient government and the donor have different beliefs on the appropriateness of the policy. Second, even if the recipient government has full "ownership" of the policy, its implementation may face resistance from domestic interest groups. Third, conditionality is a signaling device by the government, which sends a message to potential private investors on its commitment to implement the required policies and maintain a sound economic environment.

3. Conditionality in policy-based lending has been the subject of extensive research for more than two decades, including analyses in the academic literature and important reviews of conditionality undertaken by the Bank since the introduction of policy-based lending in the early 1980s. The literature identified a number of cases where (a) recipient governments accept the conditions attached to aid in anticipation that they will renege, (b) donors fail to apply sanctions stipulated in the conditionality contract, and (c) recipient governments also anticipate that it will be granted funding in subsequent periods despite previous slippages. Several authors have been critical of conditionality, suggesting that it may infringe on national sovereignty, undermine democratic processes and institutions in recipient countries, and has been ineffective in bringing about the desired outcomes.

4. The main lesson learned from the literature is that conditionality can be useful in helping identify and implement necessary reforms but that it is only when there is "ownership" of the policy that conditionality can succeed. Conditionality helps when it supports governments already strongly committed to reform.

5. The evidence shows that borrower compliance with World Bank conditionality was rather poor during the 1980s but that it has gradually improved. For recent years, the

Bank's compliance record as measured by the Operations Evaluation Department is good. However, the literature suggests that conditionality has been an ineffective mechanism to induce reform from unwilling governments and often not an appropriate mechanism for genuine reformers. The main reasons why traditional conditionality has been largely considered as ineffective in the literature—i.e., why borrower compliance rates were initially low, and why donors have refrained from enforcing the agreed upon conditions by punishing noncompliance—are lending pressures, donor altruism, or "defensive lending" (lending in order to repay the previous loan).

6. Two theoretical approaches have been used to conceptualize conditionality. First, it has been viewed in a principal-agent framework. The principal offers a contract that provides the agent with the appropriate incentive to align their respective objectives but the agent enjoys private information on its ability, opportunities, and intentions that affect the action it takes and ultimately the principal's objective. Second, conditionality has been analyzed in a political economy framework. Even if the preferences of the government and the donor are congruent, domestic conflicting interests between the government and, say, special interest groups provide a rationale for conditionality. The interest groups may not favor the proposed reform policy and have the ability to take actions that are costly to the government, such as strikes, or simply have the power to veto the reform. In this case, the government action is bound to be politically impaired and conditionality is necessary to counterbalance the presence of the interest groups.

7. As a result of internal and external reviews pointing to a lack of effectiveness of traditional conditionality, the World Bank and other donors have adapted their conditionality. The Bank has embraced selectivity (i.e., channeling aid only to countries that are committed to reform) as a guiding principle of its lending, and it increasingly relies on performance-based conditionality. Selectivity rests on the assumption that donors have no influence on domestic policies. Instead of trying to induce governments to reform or create reformers, donors select genuine reformers and provide them with financing. The donors thus replace ex ante conditionality with ex post conditionality. They may condition their financing on policies or outcomes—i.e., donors select the countries to support either on the basis of the policies they implement or depending on the results they achieve.

8. New forms of conditionality are increasingly being used, such as the peer-monitoring mechanisms used by the New Partnership for African Development. The trend appears to be toward more transparent ex ante criteria or prior actions. The Bank has moved strongly in the direction of programmatic lending and streamlining conditions, which has contributed to greater ownership. An eclectic mix of traditional and new approaches is already being used—with programmatic policy-based lending offering a particularly promising way to reconcile the debate between the traditional ex ante approach and the aspirations of a results-based approach to conditionality. Rather than insist on conditionality in specific loans, donors have begun to impose their expectations on the concessional windows such as IDA. The success of the IDA replenishment itself has been increasing conditional on the World Bank agreeing to reshape its lending priorities to accommodate donor demands.

THE THEORY AND PRACTICE OF CONDITIONALITY: A LITERATURE REVIEW

I. INTRODUCTION

1. Policy-based conditionality—or simply conditionality—linking the release of funds to the implementation of a desired action or policy is a central element in the aid relationship between international financial institutions (IFIs) and recipient countries. The International Monetary Fund (IMF) has used conditionality since its inception. At the World Bank, it was used only sporadically in a project context but it gained in importance in the early 1980s in the context of policy-based lending, with structural adjustment programs. Through their conditionality, the IFIs require a recipient government to take a specific action at a prespecified date to secure the release of funds.

2. Conditionality in policy-based lending has been the subject of extensive research for more than two decades. In recent years, the use of conditionality by the World Bank and the IMF has come under renewed scrutiny. The objective of this paper is to review the theoretical and empirical literature on conditionality. The paper cannot pretend to do justice to this vast literature as it inevitably must leave out several important aspects. Its ambition is limited to presenting the analytic frameworks developed in the literature on policy conditionality. The paper offers an assessment of whether these frameworks provide a deeper understanding on how conditionality works in practice. It draws on the work carried out by the Bank itself as well as other international financial institutions, and on the academic literature.

3. This literature provides insights on the workings of conditionality. It recognizes that conditionality in the World Bank has evolved over the last 25 years as the Bank internalized the lessons from experience. While some policymakers found conditionality to be useful, others were more critical. The Bank has considerably shifted and streamlined its approach, moving from traditional conditionality to programmatic lending. This has contributed to a new perception of conditionality and perhaps greater ownership. Two important questions are answered in this paper: (a) how did the IFIs, especially the World Bank, adopt those findings and reform their policies on conditionality, and (b) do the responses of the IFIs address some of the factors determining the effectiveness of conditionality?

4. This note recognizes that there are different definitions of conditionality in the literature. The Bank's operational policy defines "conditionality" by stating "The Bank determines which of the agreed policy and institutional actions by the country are critical for the implementation and expected results of the program supported by the development policy loan.[1] The Bank makes the loan funds available to the borrower upon maintenance of an adequate macroeconomic policy framework, implementation of the overall program in a manner satisfactory to the Bank, and compliance with these critical program conditions." The IMF formally defines conditionality as "… a way for the IMF

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[1] This has been noted in other contributions to this review. See World Bank, *Legal Aspects of Conditionality in World Bank Policy-Based Lending*, (SecM2005-3090/2), June 2005.

to monitor that its loan is being used effectively in resolving the borrower's economic difficulties so that the country will be able to repay promptly, and make the funds available to other members in need." From the perspective of the IMF, conditionality is meant to put in place the necessary safeguards to ensure that the funds made available to the borrower are used for their intended purposes and in a manner that does not jeopardize their contractual servicing and repayment (Khan and Sharma 2003).

5. Conditionality has greatly evolved during the last two decades. Although a historical perspective of the evolution of conditionality would be useful for a full understanding of its practice, it is outside the scope of this note. This paper emphasizes the conceptual aspects of conditionality rather than its historical evolution. In this note, conditionality will refer to the set of conditions a donor attaches to the release of the funds it provides to the beneficiary. The resources are made available upon the (promise of) implementation of a set of policies the borrower and donor agree upon. This is the "traditional" view of conditionality, on which the first part of this note will focus. Section VI of this note discussed how, following reviews and assessments of traditional conditionality, a new approach to conditionality has emerged in recent years.

6. ***Structure of This Paper.*** Section II provides a taxonomy of the situations where conditionality serves a purpose. Section III presents a brief overview of the existing literature, particularly some of the work carried out by the Bank itself. Section IV focuses on traditional conditionality as it has worked and identifies the factors driving the effectiveness of conditionality. Section V reviews the theoretical frameworks that have been proposed in the academic literature to conceptualize conditionality. Section VI examines how the Bank internalized the findings from the literature and adjusted its policies to improve its practice of conditionality. Section VII summarizes the paper's findings.

II. Rationales for Conditionality in the Literature

7. Before reviewing the literature, it is important to understand the rationale for conditionality. The basic idea underlying conditionality is that the donor provides incentives to the borrowing government for the implementation of policies that would improve the welfare of its citizens. At first it may seem paradoxical that the government needs externally provided incentives to carry out such beneficial policies.

8. The government may simply not know of the policy in question. In that case, it is sufficient that the donor provides technical assistance and advice to make the government aware of the right policy. Once the government is convinced of the usefulness of the policy it would simply unilaterally and willingly implement it. Conditionality serves no purpose in this context; the donor certainly does not need to reward the government on top of its advice for implementing the policy. It may even be counter-productive since it provides the government incentives to reverse the policy. Coate and Morris (1996) argue that conditionality is beneficial in this context if it is used as a convenient way to convey a message of commitment. Though it may conceivably be a relevant feature for some least developing countries with weak capacity, government ignorance is generally not

considered a factor in this paper: unless otherwise explicitly noted, the recipient government is assumed to be fully able to assess the impact of the conditionality policy.

9. There are at least three cases in which conditionality in principle serves a purpose.[2] Each of these cases lends itself to a specific theoretical treatment to which this note will come back in later sections. First, *the recipient government and the donor have different beliefs on the appropriateness of the policy for improving social welfare*. They have divergent preferences on the policy to implement. There is an "ownership" failure in the sense that the recipient's preferred policy does not coincide with the one favored by the donor.[3] Conditionality is necessary in this context; the donor compensates the recipient for the expected loss concomitant to the adoption of the policy. The donor 'buys' the reform. This case reflects the early experiences of conditionality.

10. Second, the recipient government fully owns the policy, it is committed to implement it, and the donor is eager to support. *The government may however face domestic resistance for the implementation of such policy*. Implementing the policy comes at a political cost for instance or can simply be vetoed by opposing forces. The government may also know that the policy is the right one for overall welfare but has an incentive to deviate from that policy and enact a different policy preferred by, say, special interest groups who make contribution to the government. In both cases, conditionality serves a purpose and the donor will have to compensate the government for the expected costs of reform and the implementation of the policy. In the usual jargon, the donor will have to meet the participation constraint of the government.

11. Third, *conditionality may be used as a signaling device by the recipient government*. By agreeing to implement a program and comply with its conditions, the government sends a message to potential private investors on its commitment to implement the required policies and maintain a sound economic environment. Endorsing conditionality helps the country establish the credibility and predictability of the policy environment. It also allows the government to distinguish itself from nonreformers. This argument is put forward by Dhonte (1997) and by Marchesi and Thomas (1999). Whether the recipient country "owns" the policy is immaterial, it will accept conditionality whenever the expected costs associated with the policy are lower than the anticipated benefits from higher foreign investments.

12. Collier et al. (1997) identify four rationales for conditionality: (a) inducement, where the donor offers aid as an incentive to change or adopt policies, (b) paternalism, where the donors believe they know what is best for the recipient's welfare, (c) restraint, when the recipient needs a commitment device for a particular policy and conditionality as credible threat to avoid reversal, and (d) signaling, whereby a message is sent to the (international) private sector and other donors that domestic policies will improve. The ownership-failure case encompasses both inducement and paternalism rationales. However, full borrower ownership does not fit into the Collier et al. (1997) typology.

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[2] Williamson (1983) offers one of the earliest and most comprehensive set of studies on conditionality.

[3] There is ownership failure from the donor's standpoint. It is actually the donor who owns the policy since it reflects more the donor's than the recipient's objective (Killick, 1997).

III. Overview of the Literature on Conditionality

13. Conditionality in policy-based lending has been the subject of extensive research for more than two decades. This section presents an overview of some of the work carried out by the Bank itself, the experience of other international financial institutions, the academic literature, and analysis by civil society organizations.

A. Reviews of Conditionality Undertaken by the Bank

14. The Bank has been analyzing its own conditionality since the introduction of policy-based lending in the early 1980s. These efforts include the following:

- ***Early reviews of conditionality.*** The Bank reviewed its experience with conditionality in three very detailed reports on adjustment lending in 1986, 1990, and 1992.[4] In addition, in 1995 the Operations Evaluation Department (OED) conducted an extensive study of the Bank's experience with adjustment lending in the 1980s, including conditionality.[5]

- ***World Bank reviews of conditionality in the 1990s.*** The Bank's reviews of conditionality in the 1990s focused more on the effectiveness of its lending instruments, and less on the specific design of programs and the associated conditions.

- ***Research on aid effectiveness.*** A dominant lesson of the research on aid effectiveness[6] in the 1990s is the importance of country ownership: donors can advise on and support, but cannot buy or induce, economic reforms.[7] One conclusion could be to forgo ex ante conditionality involving promises of future actions and instead allocate policy-based loans on the basis of a country's track record. Research also suggests that programs yield long-term benefits if a country's policy environment is favorable. This suggests that policy-based lending should focus on countries with good policies. More recent contributions confirm the relevance of ownership as the driver of reforms, by showing that surges in finance do not lead policy reforms.[8]

- ***Annual Review of Development Effectiveness (ARDE) 1999.***[9] The ARDE report (discussed in greater detail in Section VI) confirmed that conditionality could foster a country's commitment to ongoing reform when there was true ownership of those policies.[10]

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4 See World Bank (1986b); World Bank (1990); and World Bank (1992a).

5 See Jayarajah, and Branson (1995).

6 See in particular World Bank (1998); Dollar, and Svensson (2000); and Devarajan, Dollar, and Holmgren (2001).

7 See Devarajan, Dollar, and Holmgren (2001).

8 See Alesina and Dollar (1998).

9 See World Bank (1999a).

10 As a framework for assessing borrower ownership, the OED report refers to Johnson and Wasty (1993).

- ***Adjustment Lending Retrospective.***[11] The Retrospective (discussed in greater detail in Section VI) concluded that the initial focus on short-term balance of payment support had largely given way to a focus on sustained support for complex and often unpredictable medium-term reforms and suggested that a programmatic approach was better suited to deal with the need to support countries in their increasing focus on medium-term structural and institutional policy programs.

15. ***Recent World Bank Reviews of Conditionality.*** In these reviews the Bank has paid significant attention to the different design aspects of conditionality, including those associated with the initiatives to enhance country ownership of programs and streamline conditionality as well as with Bank-Fund collaboration.[12]

- ***Programmatic Adjustment Lending Retrospective.***[13] The Retrospective (discussed in greater detail in Section VI) took stock of experience with the programmatic approach, and concluded that the programmatic approach had been robust and effective in a wide range of country circumstances.

- ***Reviews of Bank-Fund collaboration.*** The Bank's review of its conditionality has also been carried out in the context of reviews on Bank-Fund collaboration, which were discussed by the Boards of both institutions.[14] Building on the earlier division of labor set out in the Concordat of 1989, a strengthened framework for Bank-Fund collaboration was introduced in 2001. Under this framework, staff are expected to provide coherent support to countries through early and systematic coordination on programs and conditionality, with each institution focusing its conditionality on those areas that are deemed critical for the success of their respective programs. A special framework is provided for low-income countries, where the Poverty Reduction Strategy Paper (PRSP) process defines an overarching framework for that collaboration. The reviews carried out thus far show that both institutions have made reasonably good progress in the strengthened collaboration framework, but that there is room for improvement as well as a need to monitor and review developments in the future.[15] The next review of Bank-Fund collaboration is expected to be concluded by end-2007.

- ***Annual Review of Development Effectiveness 2003.*** The 2003 ARDE (discussed in greater detail in Section VI) focused on the effectiveness of Bank support for policy reform, acknowledging that the Bank's approach is

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11 See World Bank (2001).
12 See Stiglitz (1998); Wolfensohn (1999); and Köhler (2000).
13 See World Bank (2003a).
14 See IMF-World Bank (2001); IMF-World Bank (2002); and IMF-World Bank (2004).
15 The reviews have been based on surveys of authorities, Executive Directors, mission chiefs in the IMF, and country directors in the Bank, complemented with desk reviews of case studies and analytic work.

grounded in the country's leadership and ownership of the development agenda, with the support customized to country circumstances.[16]

- ***Conditionality revisited.*** Building on the previous literature and acknowledging that the traditional understanding of conditionality as leverage is a thing of the past, recent work by Bank staff revisits conditionality and examines the new forms that conditionality has taken.[17] According to this work, conditionality should be thought of as part of a cycle that also includes policy dialogue and capacity building, with the participation of key stakeholders. Policy advice cannot be prescriptive or based on standardized development models but should help countries develop their own solutions for applying principles that have been recognized as valid development approaches. The use of budget support for low-income countries called for aid agencies to continue their efforts at harmonizing their policies and procedures and increasing the predictability of their support. There are still outstanding issues—for instance, about greater reliance on process conditionality, or the recognition that fragile states present a completely different set of challenges—that future practice will need to answer.

B. Recent External Work on Conditionality

16. Examination of the Bank's experience with conditionality has included external consultations with civil society and other stakeholders. The two most important consultative reviews are the Structural Adjustment Participatory Review Initiative (SAPRI) concluded in 2001, and the Extractive Industries Review (EIR) concluded in 2004. These two consultations, which were directed by prominent figures from outside the Bank, concluded with reports and discussions between the representatives of participating civil society and the Bank.[18] The results of these consultations were reflected in the recent change in practice and operational policy.[19]

17. ***External Critiques of World Bank Conditionality.*** Conditionality has been the subject of extensive critiques from different political directions. The Meltzer commission on international financial institutions advocated limiting policy-based lending to countries with good policies.[20] Some civil society organizations have taken aim at what they consider to be excessive intrusiveness and lack of transparency in the Bank's policy-based lending. They also criticize the Bank's advice for being too narrow and policy-based lending for insufficiently considering policy alternatives in specific areas.[21]

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[16] See World Bank (2004a).

[17] See in particular Koeberle (2003) and Chapter 5 in the volume edited by Koeberle, Bedoya, Silarszky and Verheyen (2005).

[18] For SAPRI, see http://www.worldbank.org/research/sapri/index.htm; for EIR, see http://www2.ifc.org/ogmc/.

[19] See World Bank (2004b).

[20] See Meltzer et al. (2000).

[21] See Action Aid (2004); Eurodad (2003); Oxfam (2004); Save The Children (2004); and World Development Movement (2004).

18. Research has also been commissioned by groups of borrowing countries, such as the Group of 24;[22] and bilateral donors have reviewed their own positions on conditionality,[23] and think-tanks have reacted to calls from civil society and other stakeholders.[24] Other recent research looks at World Bank conditionality, selectivity, performance-based conditionality, and the implications of the aid effectiveness research.[25]

19. ***Academic Literature.*** Traditional conditionality has often been judged as overly and increasingly intrusive, infringing national sovereignty (e.g., Drazen 2002), undermining domestic democratic processes and institutions (e.g., Stiglitz 1999), and ineffective in bringing about the desired outcomes (e.g., Easterly 2005). Koeberle (2005) offers a detailed overview of this literature, which is often critical of World Bank conditionality. Using a rich database on the policy-lending operations carried out by the Bank between the fiscal years 1980 and 2003, he also assesses the validity of these critics. The main analytic ideas from this literature are summarized in the next sections.

IV. EFFECTIVENESS OF TRADITIONAL CONDITIONALITY

20. Structural adjustment initially focused on achieving macroeconomic stability and promoting liberalization (for example, by getting prices right and privatizing state enterprises). But its lack of effectiveness was associated with neglect of issues involving governance, institutional structure, policy ownership, and the social costs of adjustment. The reviews of traditional conditionality undertaken by the Bank discussed in the previous section have identified many cases where (a) recipients governments accept the conditions attached to aid in anticipation that they will renege, (b) donors fail to apply sanctions stipulated in the conditionality contract, and (c) recipient governments also anticipate that it will be granted funding in subsequent periods despite previous slippages. In these cases, the government was not really willing and committed to implement the policy but the Bank continued to provide financing. For instance, the report *Assessing Aid* (World Bank 1998) acknowledges that aid was provided to Kenya to support the same agricultural policy reforms five separate times. Easterly (2005) provides empirical evidence of repeated adjustment lending and prolonged use of IMF resources with no impact on policies or growth.

21. The main lesson learned from the literature on aid effectiveness is that financing is most effective when it complements local development efforts rather than substituting for them. Successful development depends on local ownership, local involvement, and adaptation to local conditions. The term *ownership* is used to describe countries' choice of and commitment to reforms, as opposed to their reluctant acceptance. The success of reforms depends more on underlying political economy factors than on the direct

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22 The Group of 24 discussion papers include: Buira (2002); Kanbur (2002); Kapur (2002); Wade (2001); Park and Wang (2001); Ocampo (2001); Jomo (2001); Cohen (2000); R. Webb (2000); and Oyejide (2000).

23 See DFID (2004) and Bundesministerium fuer wirtschaftliche Zusammenarbeit (2004).

24 For example, Collier and Dollar (2004); Mosley, Hudson, and Verschoor (2004); Mosley, Noorbakhsh, and Paloni (2003); and Khan and Sharma (2003).

25 Recent papers include Adams et al. (2004); Bulir and Hamann (2003); Morrissey (2004); Killick et al. (1998); Killick (2004); Koeberle (2003); Winters, McCulloch, and McKay (2004).

investments made by outside actors such as private investors or international financial institutions such as the World Bank. Aid from bilateral or multilateral sources can be a critical support to communities and countries where there is a genuine movement for change. But for reform programs to succeed, the country must be "in the driver's seat." [26]

A. How Effective Is Traditional Conditionality?

22. The broadest consensus in the literature is that traditional conditionality, as it was conceived and practiced until the 1990s, has not been a success. Evaluators of conditionality have rated it ineffective in terms of compliance with implementation of the agreed upon policies and with respect to its effectiveness to produce the intended results in terms of growth or reduction in poverty. This section summarizes some of the arguments made in the literature on the effectiveness of conditionality.

23. In the literature, the record of conditionality has, in most cases, been measured in terms of compliance rates. The quality or adequacy of the conditional policies is generally not assessed—and the only relevant indicator is whether the government implemented, without reversal, the policies in the conditionality contract—because it is difficult to evaluate whether the policies associated with adjustment lending have led to better outcomes in terms of growth and welfare. Such an evaluation involves devising counterfactuals and separating the effects of the adjustment loan/credit from other influences, and raises a number of complex methodological issues. Such evaluations are difficult but not impossible.[27]

24. Other functions are typically highlighted in practice, such as the importance of the process, signaling, coalition building, and strengthening domestic institutions.

25. Heckelman and Knack (2005) use the period 1980-2000 to study the impact of aid on market-liberalizing policies. Contrary to Morrissey (2002), the authors find that higher aid volumes have slowed the reform over that 20-year period. Easterly (2005) also finds no positive impact on policy of repeated adjustment loans to the top 20 recipients of adjustment lending over the period 1980-1999. The evidence thus suggests that that the threat of donor sanctions carries little weight in the implementation of the requested reforms. Recipients comply only with reforms of their choosing and set their own reform timing. Conditionality ineffectiveness stems from two major proximate reasons: poor borrower compliance and lack of donor enforcement.

26. Although it is generally accepted that traditional conditionality has failed, the extensive research on the subject has revealed conditions under which conditionality can be useful in helping identify and implement necessary reforms. The overarching conclusion is that conditionality can succeed only when there is ownership of the policy. Conditionality helps when it supports governments already strongly committed to reform; see Devarajan et al. (2001). The ARDE report (World Bank 1999a) confirmed that conditionality could foster a country's commitment to ongoing reform when there was

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[26] See Stern, Dethier, and Rogers (2005).

[27] A good overview of the various methodologies that are available is provided in Bourguignon and Pereira da Silva (2003).

true ownership of those policies.[28] Moreover, when there was ownership, conditionality allowed the borrowing country and the Bank to develop and nurture mutual trust and commitment. The report suggests a new and flexible approach, with conditionality as a mutual commitment device between the Bank and the borrower, suitably combined with capacity building.

27. Contrary to the mainstream literature, Morrissey (2002) suggests that conditionality has had some effect on policies. Expanding the time horizon, he asserts that under donor stimulus recipient countries have implemented many reforms. Morrissey (2002) argues that donors have influenced the direction but not the pace of reforms—that is, recipient countries have implemented proposed reforms albeit often times years after the agreed timetable. Therefore, a study on conditionality compliance would fail to exhibit any move toward implementation if it restricts itself to the loan's original timetable. This view asserts the preeminence of the recipient in the decisionmaking as to when to implement the conditional policy.

B. Aid Recipients' Compliance Record

28. Do borrowers comply with conditionality? This is the central issue in assessing the effectiveness of conditionality. It is misleading to use program success, as several studies have done, to assess conditionality effectiveness because, as stated in Morrissey (2004), even if the borrower fully complies with the conditions, there is no guarantee that the outcomes will be as anticipated. The conditions maybe inappropriate or external factors may have undermined their impact. What is important for our purpose is that the conditions be implemented as agreed, this is the relevant indicator and it is easy to monitor if conditions are precisely stated and quantifiable actions defined.

29. The literature provides some evidence that borrower compliance with World Bank and IMF conditionality was poor during the 1980s but has gradually improved. The Bank's compliance record as measured by OED is quite good. The external literature, which often refers to data from the 1980s, is more critical. Considering 100 World Bank adjustment programs, Killick et al. (1998) infer from delays in second and third tranche disbursement that slippages occur in more than 75 percent of the programs. Delays in disbursement might signal that the conditions are, in fact, being enforced, on the basis that the Bank may refuse to release the funds for noncompliance. However, although compliance does not follow the delays, disbursement rates are near 100 percent, which means that the funds are in the end released irrespective of performance. World Bank (1999b) analyzes compliance with adjustment lending in 34 Sub-Saharan African countries, and finds that less than 30 percent of the countries have a good compliance record.

30. ***Conditionality as an Instrument for Policy Reform.*** White and Morrissey (1997) and Morrissey (2004) show that conditionality has been an ineffective mechanism to induce reform from unwilling governments and an inappropriate mechanism for genuine

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[28] As a framework for assessing borrower ownership, the OED report refers to Johnson and Wasty (1993).

reformers. Many case studies, such as Devarajan et al. (2001), Mosley et al. (1995), and Killick et al. (1998), show that traditional conditionality as an instrument for the promotion of policy reform is rather ineffective. This is especially true when the government is not fully committed to implement the reform. Using a sample of 21 countries, Killick et al. (1998) shows that governments comply only with conditions they believe serve their best interest. Dijkstra (2002) arrives at the same conclusion using cases studies for 8 countries. In the same vein, Dreher (2002) and Mosley et al. (2004) use econometric methods to reveal the determinants of compliance rates. Mosley et al. (2004) find that certain country characteristics—such as income level, economic performance, and political stability—explain a sizeable degree of compliance rate variation. Dreher (2002), on the contrary, shows that only regional autonomy and elections significantly and positively influence compliance rates. Recipient countries comply with the conditions of their choosing and at the time they want. Compliance rates are significantly lower during sensitive political periods such as election or pre-election years. Dollar and Svensson (2000) also show that implementation of conditions is almost entirely explained by domestic political variables.

31. On balance, it can be said that compliance with traditional conditionality was rather weak at the beginning but improved over time as the World Bank incorporated in its practice the lessons of experience. Koeberle and Malesa (2005) provide evidence on how conditionality has evolved from 1980 to 2003 and conclude that (a) the average number of conditions decreased; (b) single-tranche adjustment operations are usually of higher quality than multitranche operations; (c) loans with fewer conditions are generally of higher quality than loans with many conditions; (d) World Bank policy-based lending is selective and favors better-performing countries; (e) the average number of conditions is lower in better-performing countries; and (f) the focus of conditionality has changed from short-term reforms to longer-term and more complex issues. To reform conditionality, one needs to understand the reasons for this poor compliance record. This issue is discussed in the next section.

C. World Bank Enforcement Record

32. The evidence on World Bank enforcement of terms and conditions of the aid contract when slippages occur differs depending on the source. Among the external literature, Killick et al. (1998) find that out of 16 cases of noncompliance, the World Bank condoned 12 by not enforcing the contract and denying future credits to the noncompliers. Killick et al. (1998) argue that loans are always disbursed regardless of compliance record. And Dreher 2002 claims the cancellation rate of World Bank programs is close to zero. This is corroborated by Svensson (2003), who shows that the profile of loan cancellation is the same for successful and unsuccessful operations. Mosley et al. (1995) show that the World Bank is even less likely to punish noncompliers with high debt service, which lays the bedrock for moral hazard. Dijkstra (2002) shows that the World Bank stopped many structural adjustment loans for not respecting the conditions. However, the World Bank almost immediately thereafter engaged in renegotiations with the countries to fund a new loan. In any event, the donor sends the "wrong" message to borrowers, undermines the credibility of sanctions, and harms the donor's reputation.

33. By contrast, several studies within the World Bank strongly suggest that the record of compliance with conditionality has been markedly improving over the last decade. For instance, an early study by OED (World Bank 1992c) found that tranche release rates were close to 100 percent although compliance rates with agreed upon conditions were below 50 percent.[29] Another OED study (World Bank 1997) shows that of the total amount the Bank allocated to adjustment lending between 1980 and 1996, 72 percent went to countries with poor track records on compliance with conditionality. The most recent OED evaluations indicate that policy-based operations seem to increasingly meet their development objectives. Operations are considered to have satisfactory outcomes if they achieve or exceed their main goals; this includes the relevance of and compliance with conditionality.[30] OED satisfactory outcome scores for policy-based lending increased from 60 percent in the 1980s to 68 percent in FY90-94, then rose to 82 percent in FY00–04. Most ex ante conditions in recent World Bank policy-based loans have been met. In addition, the Annual Review of Development Effectiveness 2003 also found that the Bank was successful in linking its support with good and/or improving policy environments.[31]

D. Factors Explaining the Limited Effectiveness of Traditional Conditionality

34. The previous discussion raises two closely intertwined questions: (a) what explains low compliance rates by borrowers, and (b) what explains low donor enforcement of agreed upon conditions?

35. Among the reasons for lack of enforcement are lending pressures, donor altruism, and defensive lending. Pressures to lend or "push the money" have been repeatedly invoked in studies about the World Bank. Kanbur (2000) cites numerous sources of pressure to release funds in the absence of compliance. Pressures may be exercised by private contractors (international or domestic), bilateral donors, and even other multilateral donors when there is cross-conditionality, for instance. Villanger (2002) shows in a multidonor model that conditionality may fail if companies that contract with the recipient have an influence on the donors. World Bank (1992b) also suggests that staff feel pressured to spend their budget and that this undermines implementation effectiveness and hence aid effectiveness. Dreher (2002) also argues that there are built-in pressures to lend in the World Bank because it finances its lending with money from the private capital markets.

36. Altruism may also prevent enforcement. In the short term, punishing the borrower for noncompliance by withholding resources only worsens its situation. Indeed, the borrower is probably expecting the funds left in the higher tranches of the loan to implement its own plan. Blocking the funds could disrupt the borrower plan and increase poverty, to which the donor is averse. This is certainly the case in Ghana, as reported by Kanbur (2000), where following a violation of a condition in its structural adjustment credit, suspension of the tranche resulted in the World Bank holding up as much as one-

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29 See Kanbur (2000).
30 See World Bank (1999a).
31 See World Bank (2004a).

eighth of the annual import bill of the country. Not releasing such an important amount of funding could have seriously affected the economy. The donor is faced with the Samaritan's dilemma,[32] especially when it cannot assess the reasons for noncompliance, such as adverse external shocks beyond the recipient's control.

37. The donor may also engage in defensive lending (i.e., issuing new loans or continuing to disburse despite noncompliance to enable the recipient country to service previous loans). Institutional incentives not to stop the lending pipeline may also exist. As stated by Thomas (2004), studies show that such perverse institutional incentives play out within the World Bank. However, the same studies have failed to demonstrate that these incentives are the "predominant cause of the Bank's failure to enforce."

38. There are several possible explanations for low compliance rates by borrowers. Compliance has been low for policies for which there was no sense of ownership, for politically difficult reforms, or reforms required to be implemented in sensitive political periods. The borrower may refuse to comply after agreeing to the conditions only because it feels that donor's sanction for noncompliance is not a credible threat. Considering the World Bank record, Thomas (2004) calls this the "enforcement critique," and concludes that the "Bank's failures to enforce have not been shown to be the predominant cause of poor borrower implementation," and that "no study has attempted to evaluate the extent to which failure to enforce was responsible for borrower noncompliance." The government may not be able to implement the policies it agreed upon because of domestic political reasons. Special interest groups whose rents may be jeopardized by the reform may lobby to block implementation.

39. Among other possible reasons for the mixed record on compliance are lack of capacity to implement agreed policies, especially in low-income countries, and the rigidity of traditional conditionality, which requires a specific action to be taken at a specific time. The institutional setting in the borrowing country may be such that straightjacket deadlines cannot be met, which implies lack of compliance. A large number of conditions can also constitute an impediment to compliance by undermining the willingness of the government to reform if it feels overburdened by the requirements.

V. Theory of Conditionality

40. Two approaches have been used in the academic literature to conceptualize conditionality. The first coherent framework to analyze conditionality is game theory, which uses as a prism the principal-agent framework. The risk with this approach is that it may tend toward an ahistorical analysis, which is why several authors prefer to view conditionality in terms of conflicts of interest in a political economy context. Several

[32] The expectation of charity can undermine the incentives to work and lead people to behave in ways that keep them in poverty. Buchanan identified this as the "Samaritan's dilemma." It is basically a time-inconsistency problem. Possible solutions to this dilemma involve punishment within an iterated game, reshaping the game in the direction of a dynamic one-shot game, and the delegation of the power of decision to an agent. See Buchanan (1972). For an easy-to-read presentation, see Dixit and Nalebuff (1994).

features of conditionality viewed as a complex game (such as the enforcement critique) will ultimately have to be solved empirically. This section presents the main features of these theoretical approaches.

A. Principal-Agent Framework

41. The most appropriate tool available to economists to understand conditionality is the principal-agent model. This model contrasts two players with conflicting objectives. The principal offers a contract to the agent that provides it with the appropriate incentive to align their objectives. A fundamental feature of the principal-agent model is the asymmetry of information between the two actors. The agent enjoys private information on her ability, opportunities and intentions that affect the action it takes and ultimately the principal's objective.

42. The principal-agent framework is well-suited in the case of an ownership failure. Indeed, the donor (the principal) offers aid as an incentive to the recipient government (the agent) to align their preferences. The lack of ownership reflects the conflict of interests. The basic framework in the literature is one in which the donor has altruistic preferences and cares about, say, public spending aimed at poverty reduction, whereas the recipient government weighs poverty reduction with some other component that benefits only segments of the population (e.g., the elite). As the donor is seen as more concerned with the poor than the recipient government, it typically relies on conditionality to enforce compliance with poverty reduction policies. The principal then will make transfers to the recipient "conditional" on increases of poverty reduction spending. The agent enjoys private information on its cost of choosing the donor's preferred policy. The donor may not be able to observe the action but only the final amount of poverty reduction spending, in which case we are in a moral hazard setting, as in Svensson (2000, 2003) or Azam and Laffont (2003). Adverse selection, on the other hand, arises when the donor is uncertain about the weight the recipient government attaches to poverty reduction spending. Mosley et al. (1995) and Killick (1997) are among the pioneers in applying the principal-agent framework to foreign aid.

43. In the principal-agent framework, the effectiveness of conditionality hinges on the ability of the principal to commit to enforcing the contract. The strength of the donor's commitment ability is inversely related to its degree of altruism. Indeed, a highly altruistic donor will always release the funds even though the recipient government does not implement the required action. As long as the donor does not have access to a commitment technology that will help carry out the sanction ex post, the recipient government will have the upper hand because it knows and takes advantage of the donor's altruism. In the worse case scenario, the recipient may even want to impoverish the country to receive higher aid transfers.

44. It is now widely accepted that the principal-agent is the best theoretical vehicle to operationalize the traditional conditionality relationship. There is also a consensus in the literature that the ultimate factor that makes aid ineffective to induce policy reform is the inability of the donor to strongly commit to enforcing conditions. What can the donor do

to signal commitment? Did donors learn from the findings of the literature and adjust their conditionality policies?

45. The objective of the recipient government is to keep the donor within this environment. The donor, a victim of the Samaritan's dilemma, will be unable to achieve any sustainable and tangible change in the recipient country. The recipient country will each year renege on its promises to make reforming efforts. The heart of the problem is the donor's access to a commitment technology to carry out sanctions. This would render the donor's threat to stop the aid flows credible. The recipient will in turn realize that the donor is serious about withholding funds if the policies agreed upon are not implemented. There are at least three ways to access that technology.

46. First, the donor may use yardstick competition by considering several recipient countries at the same time. Since the donor is equally altruistic toward the poor population in the recipient countries it will only reward the government that implements poverty reducing reforms. This is a time-consistent strategy since the return of aid is highest for the reforming country. However, with diminishing returns to aid there may be a point beyond which the donor will give transfer to the nonreformer. Not reforming on the other hand becomes a dominated strategy. This idea has been considered by Svensson (2003) and Federico (2001). Yardstick competition can be interpreted as selectivity whereby the donor rewards only the committed reformers.

47. A second tool at the disposal of the donor to enhance its commitment ability is the inherently dynamic nature of the donor-recipient relationship. Aid relationships are clearly repeated interactions over the long term. The Bretton Woods institutions have now been active for over 60 years, and the Bank has been providing policy-based loans for 25 years, sufficient time to build an "enforcer reputation. Clearly in a one-shot game there is no reason for the donor not to give the aid if it helps even marginally reduce poverty. However, in a longer-term perspective, the donor may be willing to incur the cost of having high poverty rates for the few periods necessary to establish its reputation. This would enable the donor to "force" the recipient government to take the right action for the remaining (infinite) periods.

48. Third, the donor may delegate the task of aid giving to a third party that is less averse to poverty. The donor will still have to write a contract with that third party. Delegation can be costly and is not immune to collusion. Svensson (2000) proposes the delegation of aid to multilateral institutions, which are supposedly less averse to poverty and less prone to commitment problems.

49. Yardstick competition, also an appealing idea, suffers from a serious drawback. It does not take into account the possibility of collusion among the recipient countries. Because the recipient countries do not want to exert any reform effort, they may collude and agree to carry out the same effort level, say zero. In this scenario, the donor is still faced with identical countries that have backtracked on their reform promises. The donor still cares about poverty reduction and will equally divide the aid budget among the recipient governments. It should be noted that this collusion issue may be mitigated by increasing the number of countries that compete for a given budget. Indeed, because of

coordination problem and costs of communication, the likelihood of collusion is inversely related to the number of competing recipients. It must, however, be noted that collusion is highly unlikely unless the donor explicitly shapes the game as a tournament.

B. Political Economy Perspective

50. The principal-agent framework is a good vehicle for the conditionality game when the recipient does not own the donor's favorite policies. Indeed, when there is recipient ownership, the conflict of interest seemingly disappears and so does the need for conditionality. Drazen (2002), however, argues that conditionality and ownership are both central to aid programs. Khan and Sharma (2003) support the same claim. As recognized by Drazen (2002), in order for conditionality not to be redundant (or counterproductive) there must exist a conflict of interest *somewhere*. If government and donor preferences are congruent, domestic conflicting interests between the government and, say, special interest groups provide a rationale for conditionality. The interest groups may not favor the proposed reform policy and have the ability to take actions that are costly to the government, such as strikes and so forth. They can also simply have the power to veto the reform. In this case, conditionality is necessary to counterbalance the presence of the interest groups. The fact that domestic political factors are important for compliance with conditionality is demonstrated by Dreher (2002), who empirically shows that compliance is low during election and pre-election years, meaning governments refrain from implementing prescribed policies that may jeopardizes their political future, even though they reflect government preferences.

51. The political dimension of the aid/conditionality relationship has been recognized by the literature since at least the seminal paper of Boone (1996), which shows that aid is ineffective when the regime in place is not "liberal." Svensson (1999) also shows that politics is an important ingredient to determine the effectiveness of aid. Dollar and Svensson (2000) show that the length of tenure of the incumbent government and whether it has been democratically elected are significant determinants of reform and adjustment program success.

52. There are many political obstacles to economic reforms that induce the government to postpone reforms for better times, for instance after elections. There is a growing literature on the political economy of reform that tries to explain poor compliance with conditionality and weak implementation of reforms. This literature mainly argues that reforms are delayed or not implemented because of the presence of conflict of interests between the government and entrenched interests groups. The latter have an interest in the maintenance of distorting policies and an incentive to oppose reforms aimed at removing them, including reducing or removing tariffs, privatization of state-owned enterprises, or land redistribution. The political economy of reform, which dates back at least to Alesina and Drazen (1991), has been usefully applied to the aid and conditionality game and helps sharpen our understanding of an important determinant of the success of conditionality. Many papers using this framework have recently emerged that discuss conditionality when domestic politics are the driving force for reform implementation; see, for example, Mayer and Mourmouras (2002), Joyce (2004), Drazen (2002) for IMF conditionality, and Johnston and Wasty (1993) for the World Bank.

53. The purpose of conditionality in this setting is to support the recipient government in its battle against special interest groups, to implement policies that benefit the majority. Conditional assistance can strengthen the bargaining position of the government in its move to push reform.[33]

54. To conclude, the literature has revealed one proximate and two ultimate factors that may drive the lack of effectiveness of conditionality. The proximate factor is ownership, on which most of the literature and IFI efforts have concentrated. When there is no ownership of the reform, it is the inability of the donor to back up the threat of sanctions with a credible commitment technology that undermines the donor effort to "buy" the reform. When the government is committed to the policy, the power of special interest groups to influence the policymaker's choice is the main determinant of the success or failure of conditionality.

VI. New Approaches to Conditionality

55. The international financial institutions have gradually adjusted their practice, learning from operational experience and integrating the main findings of the extensive research on conditionality. This section briefly discusses (a) the operational changes that have taken place, (b) the move to ex post programmatic lending, and (c) the range of proposals—some of them radical, such as pooled funding—that have been put forward to reform conditionality.

56. ***Changes in Operational Approach.*** The Comprehensive Development Framework—which outlines the way in which the World Bank should do business with recipient countries and other development partners—was introduced in 1999. It promotes four principles, addressing past shortcomings in development assistance. First, development efforts should be rooted in a long-term, holistic vision of a country's needs, not just macroeconomic but also social and structural. Second, it should focus on results rather than inputs. Third, it should be based on country-owned strategies. And fourth, development actors should foster partnerships to support the country-owned strategy. These principles provided the backdrop for a major innovation in aid delivery—the poverty reduction strategy (PRS) process adopted in 2001 by the boards of the World Bank and IMF. This process became the basic springboard for all low-income country access to expanded debt relief, and then to the concessional funding windows of the two institutions—the IDA and the Poverty Reduction and Growth Facility (PRGF), respectively. It marks an advance on previous aid-delivery mechanisms in several key respects.[34]

57. First, the PRS process is more explicitly based on country ownership than past approaches. Each PRS is developed by the recipient country and presented in a Poverty Reduction Strategy Paper, through what is envisioned as a participatory process with representatives from all major groups in society.

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[33] See Hsieh (2000) for a political economy of reform model based on a bargaining game between two parties, say, government and pressure group.

[34] See Wolfensohn and Bourguignon (2004).

58. Second, the PRS process offers a new vehicle for effective coordination and harmonization among donors, reducing the costs of donor fragmentation. It is not only the explicit coordination between the World Bank and the IMF that marks an advance. Several bilateral donors, among them the European Commission and the U.K. Department for International Development, have thrown their full support behind the PRS approach and placed their own grants to low-income countries under the same discipline. For many countries, the PRS process has now become the main forum for donor coordination.

59. Third, the PRS process has supported a move away from project-centered assistance, setting development assistance in an explicit policy-consistent framework. Where countries have demonstrated some track record of seriousness in their reforms, aid is now often delivered as direct budget support through poverty reduction support credits, complementing or subsuming individual projects. To provide accountability, the PRS identifies clear targets for results and monitors progress toward them.

60. Finally and most importantly, in its emphasis on country ownership and budget support, the PRS process has supported a move away from excessive conditionality. The adjustment lending programs of the 1980s and early 1990s were marked by a proliferation of conditions—as many as 40 legally binding conditions per operation in the early 1990s.

61. While conditionality can support policy changes, it cannot persuade reluctant reformers. Since aid was becoming more focused on "willing reformers" articulating a development vision through the PRS process (i.e., on those poor countries that had relatively good institutions and policies), donors have attempted to lighten conditionality and mainly support measures the country included in its PRSP. For example, in the IMF's Poverty Reduction and Growth Facility, conditionality has become more limited, and is focused on the Fund's core areas of expertise and restricted to measures that have a direct and critical impact on the program's macroeconomic objectives.[35]

62. The change to a more country-driven process is not trivial. There is an inherent tension between a voluntary, country-owned statement of priorities (the PRSP) and a mandatory, externally driven judgment about its quality and feasibility. The two may be notionally separate—the government "owns" its strategy and the donors "own" their independent assessments of the strategy and resulting aid allocations. But in practice, different power relationships and local chemistry determine how much one actually influences the other. It is too soon to evaluate this evolution in the way of delivering aid. The implementation of this reform is taking time, both by donors (harmonization) and recipient countries (elaboration of PRSPs). But the first results are encouraging.[36]

63. The evolution over time of the practice of conditionality in both the World Bank and IMF is evidence that the IFIs internalize the findings of the literature and adapt their conditionality policy to the new findings. The changes in their practice of conditionality

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35 See IMF-World Bank (2004).

36 For evidence, see World Bank and IMF (2004).

are a response to the studies showing that fixed-tranche rigidity and high number of conditions hamper the effectiveness of conditionality. The institutions have introduced flexibility in phasing and tranching of their loans and also reduced the number of conditions. The introduction of programmatic policy-based lending gave more flexibility to the government to implement complex and unpredictable medium-term policy changes, and contributed to stronger ownership. The Bank's 2003 Programmatic Adjustment Lending Retrospective concluded that the programmatic approach had been robust and effective in a wide range of country circumstances.[37] Early experience with the approach was positive largely because of the design features that provided sufficient flexibility to facilitate a stronger focus on results, participation, and harmonization. Reliance on prior actions and on subsequent flexible triggers was seen as key to allowing greater ownership and to enhancing the predictability of Bank support.

64. The increased efforts to streamline the numbers of conditions in World Bank policy-based lending is strikingly clear in Koeberle and Malesa (2005, p.49). An initial phase of an increasing number of conditions from the beginning of the structural adjustment era was followed by a sharp decline starting in the early 1990s. The number of conditions started to decline following claims that governments were overloaded with conditions, which undermined the effectiveness of conditionality. Similarly, Khan and Sharma (2003) are strong and convincing advocates of the streamlining process adopted by the IMF.

65. Several internal reviews of the Bank document how the Bank has adapted its practice of conditionality. They show that the Bank has paid attention to the different design aspects of conditionality, including those associated with the initiatives to enhance country ownership of programs and streamline conditionality as well as with Bank-Fund collaboration.[38] The 2001 Adjustment Lending Retrospective concluded that the initial focus on short-term balance of payment support had largely given way to a focus on sustained support for complex and often unpredictable medium-term reforms. It suggested that a programmatic approach allows the Bank to base its support on performance rather than on promises, which is better suited to dealing with the need to support countries in their increasing focus on medium-term structural and institutional policy programs. The Retrospective indicated that conditionality cannot be a substitute for country ownership and reform readiness.[39]

66. The 2003 ARDE (World Bank 2004) focused on the effectiveness of Bank support for policy reform, acknowledging that the Bank's approach is grounded in the country's leadership and ownership of the development agenda, with the support customized to country circumstances. Bank lending was concentrated in countries that had relatively good policy environments, where the support backed further improvements in policies within a stable reform environment. The review noted, however, that the Bank's conditionality had not resulted in good outcomes in situations of high uncertainty. Strong analytic underpinnings were identified as a major factor contributing to the

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[37] See World Bank (2003a).
[38] See Stiglitz (1998), Wolfensohn (1999), Köhler (2000).
[39] See World Bank (2001).

success of policy programs. Nevertheless, the review noted that the Bank had not always paid sufficient attention to alternative perspectives or to individual country circumstances; it said that generic "best practices" should give way to intensified efforts to customize and adapt knowledge to specific localized problems, taking country experience into account. The review called for the Bank to "experiment with approaches that would complement intermediate indicators and conditions with indicators of direct poverty reduction results or other outcome-related indicators." It also encouraged the Bank to find ways to reduce the tension between its instruments of support and the efforts to promote country-led partnership approaches to development.

67. ***Importance of the Political Economy.*** The Bank has also increasingly been aware of the importance of domestic politics for the success of policy-based conditionality. It has acknowledged the influence that various stakeholders or interest groups have on the policy reform process and has increasingly called for the building of partnerships at the local level between the government and its constituencies or opponents to help build a broad-based consensus around the policy platform through public discussions. These efforts to achieve consensus have been shown by Drazen and Isard (2004) to enhance program ownership. The Bank also advocates partnership among donors, to harmonize their views and coordinate their efforts to more effectively support the government-owned strategy.

68. ***Selectivity.*** Recent external research that looks at World Bank conditionality shows that the World Bank has embraced selectivity as a guiding principle of its lending, and that it increasingly relies on performance-based conditionality.[40] This clearly shows that the World Bank did internalize the findings of the literature and change the way it practices conditionality to reflect that knowledge. For instance, Dollar and Levin (2004) show that the Bank is exercising higher selectivity based on the Country Policy and Institutional Assessment (CPIA) ratings when compared to other multilateral or bilateral donors. The greater selectivity applied by the World Bank in the allocation of policy-based lending is also confirmed by Koeberle (2005), who shows that during FY95-03 around 76 percent of the policy lending volume went to countries with above average CPIA scores.[41]

69. The selectivity approach implies channeling aid to countries that are committed to reform. The donors select the countries to support either on the basis of the policies they implement or depending on the results they achieve. As noted by Gunning (2000), policy-based selectivity may run into the same problems as traditional conditionality and undermine ownership. Indeed, if donors signal that they will select countries that follow good policies and simultaneously supply a predetermined list of such policies, the immediate effect is that recipients will face powerful incentives to adopt the prescribed policies. They will end up trying to implement policies they do not own. If the policies do not have a tendency to "persist" (Coate and Morris 1996), they will be reversed.

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[40] Recent papers include Adams et al. (2004), Bulir and Hamann (2003), Morrissey (2004), Killick et al. (1998), Killick (2004), Koeberle (2003), and Winters et al. (2004).

[41] See World Bank (2003b).

70. Given this caveat, outcome-based conditionality may be preferable over policy-based selectivity, as argued by Collier et al. (1997). Outcome-based conditionality has been tested in a number of African countries by the European Union. While it seems to be a promising avenue, there are serious practical drawbacks (Adams et al. 2004). Using outcomes as a basis for the selection of deserving countries has its own problems, such as the difficulty of measuring outcomes and the risk of not rewarding effort but sheer luck, because outcomes may result from policies and factors outside the control of the recipient. The heterogeneity of country circumstances may also be a difficult variable to control for. A solution proposed in the literature by Llavador and Roemer (1999) is the equal opportunity approach, where the *circumstances*—exogenous factors that counter the country's efforts (e.g., being landlocked)—of the country are taken into account and each government is rewarded for its efforts at making the economic environment enabling.

VII. Conclusions

71. This paper has reviewed the literature on conditionality, explored the benefits and drawbacks of various approaches, and attempted to provide a balanced assessment of its findings. In some cases, policymakers have found conditionality to be useful: conditionality should play a central role in policy-based lending, but it cannot substitute for country ownership and good policies. Traditional conditionality in policy-based lending has often been criticized as being ineffective and intrusive. The literature identifies a failure of traditional conditionality, which it attributes largely to the difficulty that donors have in sanctioning noncompliance. According to the literature, this weakness of the donors induces recipients to agree on ex ante conditionality, since they anticipate that they can renege and still obtain donor aid. Over time, this has led to the gradual replacement of ex ante conditionality with ex post conditionality and to a focus on ownership, selectivity, and partnerships.

72. ***Selectivity and Programmatic Policy-Based Lending.*** An exclusive focus on conditionality based on ex ante commitments or ex post results may not be practical or useful for the Bank's policy-based lending. Thus a key recommendation is to use conditionality selectively, tailored to country circumstances. Indeed, an eclectic mix of traditional and new approaches is already being used—with programmatic policy-based lending offering a particularly promising way to reconcile the debate between the traditional ex ante approach and the aspirations of a results-based approach to conditionality.[42] The Bank has moved strongly in the direction of programmatic lending and streamlining conditions, which has contributed to greater ownership.

73. The only factor that undermines the effectiveness of traditional conditionality that has not been tackled is donor capacity to enforce the conditionality contract. Gunning (2000) has discovered only one case where a government initially hostile to a reform finally implemented it and did not backtrack under donor pressure (the liberalization of the cashew sector in Mozambique). Selectivity is a revealed preference. By choosing to be selective, the donor deals with governments that own the policies and therefore

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42 Koeberle (2003).

nonimplementation comes from external factors, in which case the government should be supported, not punished.

74. ***Alternatives to Conditionality.*** What are the alternatives to conditionality? The most popular option to date is selectivity, which rests on the cornerstone assumption that donors have no influence on domestic policies. Instead of trying to induce governments to reform (or to create "champions" or reformers), donors select genuine reformers to whom they distribute the aid budget. The donors thus abandon ex ante conditionality to adopt ex post conditionality. They may aid condition on the basis of policies or outcomes. As a result, donors do not have to face a punishment decision because of noncompliance and they do not need to have a commitment technology to carry out sanctions.

75. There is however a caveat in this reasoning. Selectivity is in fact a commitment to sanction governments that do not want to follow good policies.[43] Drazen (1999) models selectivity as an incentive mechanism that donors design to induce countries to reform. For a country that refuses reform, the donor may find it necessary to wait until the recipient country's economic situation (significantly) deteriorates. The denial of foreign aid and the continuous deterioration of the recipient's situation may in the end bring about regime change. If donors can be selective, cherry-picking countries they financially support and excluding others, what prevents them from being able to enforce their conditions in the old-style conditionality game?

76. Other alternatives to conditionality include greater emphasis on country ownership of programs (as envisaged in the Bank's development policy lending) and peer-monitoring mechanisms, such as used by the New Partnership for African Development (NEPAD), which is discussed below. It is also important that there be a separation of powers between the agencies that lend the money and impose conditions and those that monitor compliance. As long as the actions of lenders separate risks from rewards (both political and financial), they will induce a "conditionality moral hazard." However, as argued by Kapur (2004), conditionality is akin to an incomplete contract and there are inherent limitations to what the instrument can achieve. According to Kapur, a more viable, albeit radical, change would be to institute broad-ranging risk-sharing contracts between individual developing countries and the wealthier countries, mediated through the IFIs.[44]

77. While the conditionality regime has stepped back from its micro-detailed orientation, the trend appears to be toward more transparent *ex ante* criteria or prior actions. Thus, rather than insist on conditionality in specific loans/credits, donors have begun imposing provisions on the concessional windows of the IFIs, beginning with IDA in the 1980s. The success of the IDA replenishment itself became increasing *conditional* to the World Bank agreeing to reshape its lending priorities to accommodate donor demands. Thus, even as donors insisted on "increasing selectivity" in World Bank lending, recent IDA replenishments have added new issues. For example, in IDA13, although donors insisted that stakeholders be involved in Bank projects, they were more hesitant when it came to stakeholder involvement in Bank policies, especially lending priorities. And while a survey of preferences of opinion leaders from IDA borrowing countries found that the agenda of "Northern" donors was near the bottom of the list of

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[43] The other side of the selectivity coin is that it may also be interpreted as a reward for reformers.

[44] This summary of alternatives to conditionality draws on Kapur (2004).

recipient countries,[45] to ensure that donor funds were spent wisely, 29 progress indicators were added to the IDA13 results measurement system. (In the end. IDA13 had a total of 23 objectives and its recommendations/actions added up to 62).[46] The Heavily Indebted Poor Countries (HIPC) initiative to reduce the debt of 41 “debt distressed” countries to a sustainable level is another example of shifting conditionality from specific loans to concessional windows. While the argument for debt reduction for these countries was straightforward, countries had to meet a set of criteria to qualify (i.e., undertake prior actions).

78. IFI conditionality has an intrinsic weakness: the design, lending, and monitoring functions are imbedded in the same institution, thereby creating an inherent conflict of interest (Woods 2000). A recent innovation is to separate the monitoring function through a peer-review mechanism. An example is NEPAD, launched in 2001. It commits African governments to democracy and good governance in return for greater aid and investment from the developed economies. Countries in the 53-member African Union can join NEPAD by signing its Democratic and Political Governance Initiative—a set of 12 commitments and eight actions—and by agreeing to an external review every three years by a panel of eminent Africans. This peer review system marks an unprecedented development in the most stressed region in the world. Thus far, 17 countries have agreed to be reviewed. The first round of reviews examining compliance with NEPAD’s standards will focus on Ghana, Kenya, Mauritius, and Rwanda, and is scheduled for completion by 2006. As a way to hold African leaders accountable, the African peer review mechanism has drawn wide interest. It represents an ambitious attempt to subject African leaders to an ongoing examination by other Africans in priority areas and to shift from donor-imposed conditionality to peer monitoring.

79. A radical option is to develop risk-sharing contracts for development on the lines proposed by Shiller (2003). Commercial examples of such contracts, while rare, are not unknown. The most obvious form is to tie the rate of interest on sovereign loans to gross domestic product (GDP) growth. For instance, in 1994 Citibank arranged a loan of US$1.865 billion to Bulgaria, whereby the higher Bulgaria’s growth rate, the greater the interest rate. Goldman and United States and the Deutsche Bank in Europe created an Economic Derivatives Market in 2002. Shiller’s proposals are much more ambitious. As described by Kapur (2004), an example of Shiller-type contract would run as follows: Country A pays other countries if its GDP did better than expected relative to other countries’ performance during the contract period, while other countries pay country A if A’s economy did less well. These arrangements would work best among countries that are both geographically and economically “distant,” since this would result in a lower risk correlation in their economic fortunes. The contract could be made not between country A and B, but between each of them and an international agency. For this to work, the contracts would have to be long term (50 or more years) and would require prior agreement on expected per capita growth rates for each country. The effect would be tantamount to an exchange of unexpected GDPs. Shiller’s plan would also include a fixed annual fee paid among countries, regardless of GDP. There is no doubt that such a proposal, which would require concerted political will, could only emerge in the long run.

[45] See IDA (2001), Tables 3 and 4.

[46] See IDA (2002), Annex 3.

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REVIEW OF WORLD BANK CONDITIONALITY
BACKGROUND PAPER 6

2005 CONDITIONALITY SURVEY:
EXECUTIVE SUMMARY AND
DETAILED SURVEY RESULTS

WORLD BANK

2005 CONDITIONALITY SURVEY: EXECUTIVE SUMMARY AND DETAILED SURVEY RESULTS

CONTENTS

ACKNOWLEDGMENTS

This background paper was prepared by Fusion Analytics LLC. The survey was based on a questionnaire prepared by staff from OPCS with support from Sharon Felzer from EXT, and Fusion Analytics LLC. The survey was conducted by Caliber Associates.

METHODOLOGY AND SAMPLE COMPOSITION

A confidential online survey on Conditionality was sent to 261 government officials. A total of 105 responses were received. The respondents are experienced in World Bank policy-based operations in the areas of monitoring, negotiating, designing, and implementing policy-based program as government officials. It is important to note that survey response was stronger in countries rated as good performers by the World Bank (for example, high or good rating in the CPIA grouped in thirds). As a result survey data are more heavily weighted to the opinions of better performing and relatively more developed countries.

Establishing a Baseline

The 2005 Conditionality survey represents the first survey by the World Bank to directly assess client opinions about working with the World Bank on policy-based operations. In interpreting these survey findings it is important to view them as establishing a baseline of client opinions. Future surveys among this important population will be ideally positioned to compare directly the effects of future policy modifications

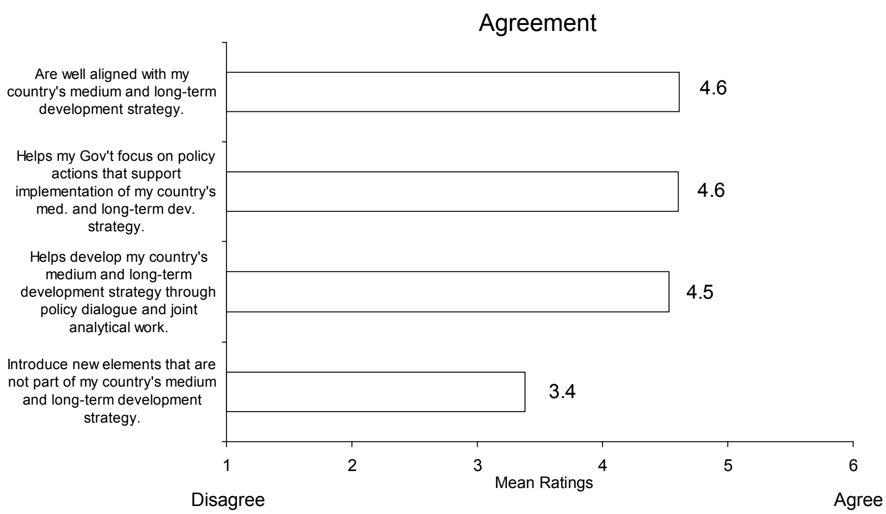
Survey Methodology

– Interview method: Confidential online survey
– Field Date: May 2005
– Available in four languages: English, French, Russian and Spanish
– Survey field duration: Approximately 4 weeks
– Sample size: 261deliverable e-mail addresses
– Survey response rate: 40% (105/261)

OWNERSHIP AND WORLD BANK-SUPPORTED POLICY PROGRAMS

Most countries have a development strategy that is widely supported in the country. World Bank-supported policy programs are perceived as well-aligned with existing country medium and long-term development strategies. Further, clients rate policy programs highly in helping their governments focus on policy actions that support implementation of development strategies and in helping develop the strategies through joint analytical work.

World Bank-supported Policy Programs…



Q5. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

World Bank-supported Policy Programs…

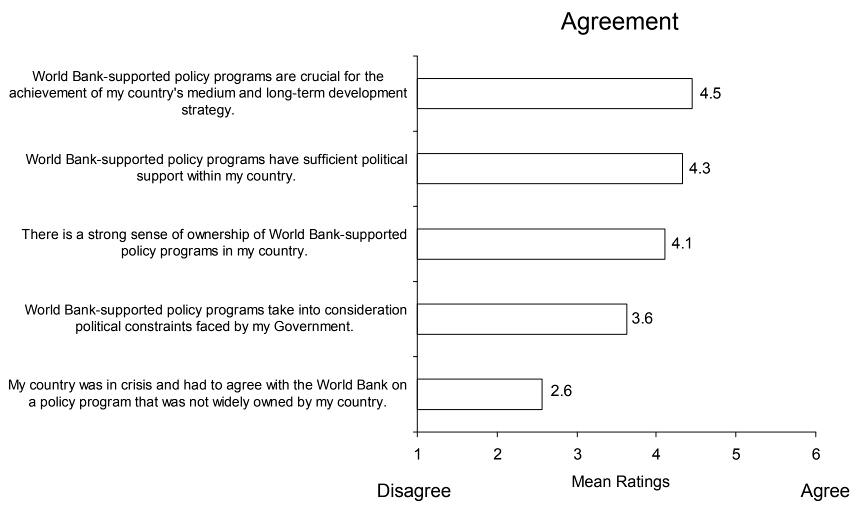
Country Code

Q5.0 World Bank-supported Policy Programs	Country Code truncated						Table Total	
	Blend		Core and Investment Grade IBRD		Core IDA and LICUS			
	Mean	Valid N	Mean	Valid N	Mean	Valid N	Mean	Valid N
World Bank-supported policy programs are well aligned with my country's medium and long-term development strategy.	4.3	N=12	4.7	N=50	4.6	N=36	4.6	N=98
The WB's partic. helps my Gov't focus on policy actions that support implementation of my country's med. and long-term dev. strategy.	4.2	N=12	4.7	N=50	4.7	N=35	4.6	N=97
The WB helps develop my country's medium and long-term development strategy through policy dialogue and joint analytical work.	4.1	N=12	4.6	N=50	4.5	N=36	4.5	N=98
WB-supported policy programs introduce new elements that are not part of my country's medium and long-term development strategy.	3.6	N=12	3.4	N=50	3.3	N=34	3.4	N=96

Q5. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Ownership of policy programs is strong. However, clients rate World Bank-supported policy programs lower in taking political constraints in their country into account, despite relatively high ratings for political support of existing policy programs in their country.

Ownership of the Policy Programs Supported by the World Bank



Q6. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements

Ownership of the Policy Programs Supported by the World Bank

Country Code

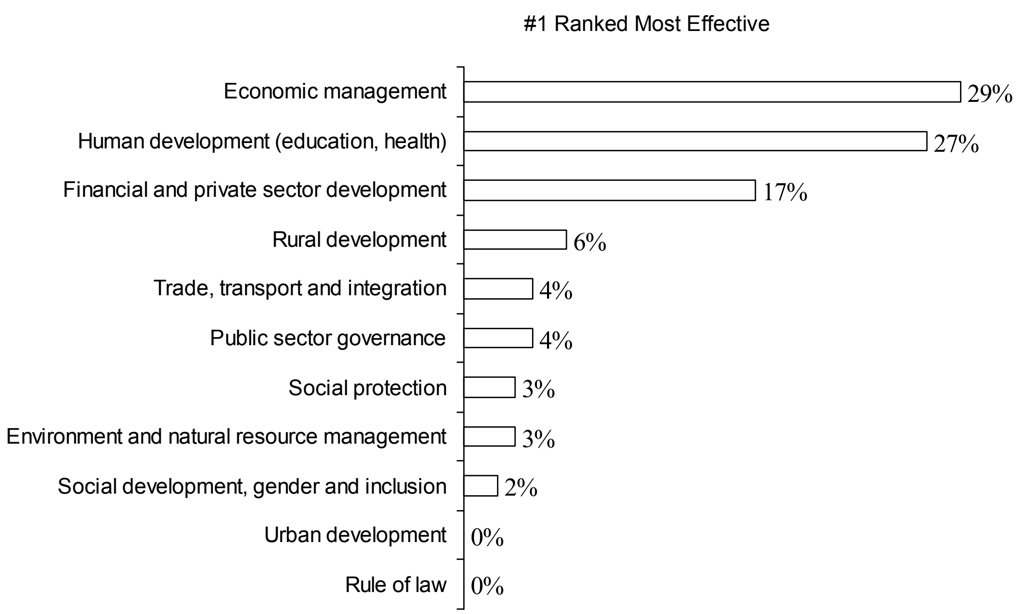
Q6.0 Ownership	Country Code truncated: Blend		Country Code truncated: Core and Investment Grade IBRD		Country Code truncated: Core IDA and LICUS		Table Total	
	Mean	Valid N	Mean	Valid N	Mean	Valid N	Mean	Valid N
World Bank-supported policy programs are crucial for the achievement of my country's medium and long-term development strategy.	4.4	N=12	4.1	N=49	5.0	N=35	4.5	N=96
World Bank-supported policy programs have sufficient political support within my country.	3.5	N=12	4.4	N=50	4.5	N=36	4.3	N=98
There is a strong sense of ownership of World Bank-supported policy programs in my country.	3.5	N=12	4.2	N=49	4.2	N=33	4.1	N=94
World Bank-supported policy programs take into consideration political constraints faced by my Government.	2.9	N=12	3.8	N=49	3.6	N=34	3.6	N=95
My country was in crisis and had to agree with the World Bank on a policy program that was not widely owned by my country.	4.3	N=11	2.1	N=45	2.6	N=35	2.6	N=91

Q6. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

CONTENT OF WORLD BANK-SUPPORTED PROGRAMS

The three areas where clients rate the World Bank's involvement as *most* effective in their country include: economic management, human development, and financial and private sector development. Critical to the World Bank's involvement in these areas are tailoring analytical work to country circumstances and sharing cross-country experience (see next page).

Areas of World Bank Involvement Where *Most* Effective



Q7 Please rank the **three** areas in which the World Bank's involvement has been ***most*** effective in your country (1 being the highest) within the following policy areas:
Source: May 2005 World Bank Conditionality Survey

How Areas of Effective World Bank Involvement Has Been Effective

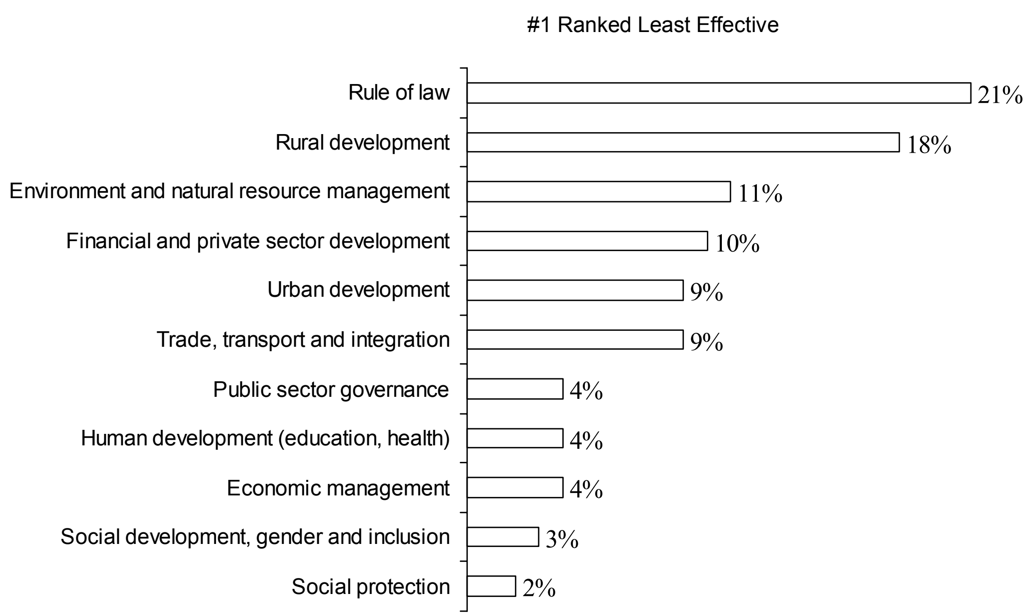
Top 3 Ranked Areas

Ways most effective:	1. Economic management	2. Human development (education, health)	3. Financial and private sector development
Sharing cross-country experience	67%	**59%**	**76%**
Tailoring analytical work to country circumstances	**70%**	**56%**	**76%**
Assessing the impact on the poor and vulnerable	52%	**56%**	12%
Assessing the impact on environment	11%	11%	12%
Alerting the government to important actions that were not foreseen in its original policy program	44%	30%	29%
Detailing/sequencing the implementation steps in the policy matrix	37%	**41%**	**47%**
Developing medium-term results framework	**63%**	**48%**	24%
Other	4%	11%	6%
	N= 27	N= 27	N= 17

Q7a. In what ways has the World Bank's involvement been ***most*** effective?
Source: May 2005 World Bank Conditionality Survey

The areas where clients rate the World Bank's involvement as *least* effective in their country are rule of law and rural development. Secondary areas include environment and natural resource management, financial and private sector development, urban development, and trade, transport and integration.

Areas of World Bank Involvement Where *Least* Effective

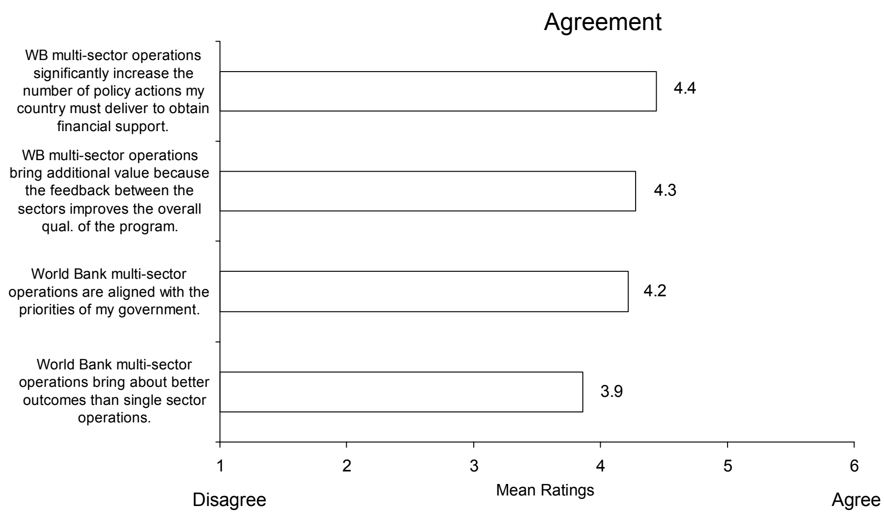


Q8. Please rank the **three** areas in which the World Bank's involvement has been ***least*** effective in your country within the following policy areas:
Source: May 2005 World Bank Conditionality Survey

ADDITIONAL ISSUES ON WORLD BANK MULTI-SECTOR OPERATIONS

Feedback between the sectors is perceived by clients as a key strength of World Bank multi-sector operations. Alignment of multi-sector operations with the priorities of their government is also highly rated. However, clients rate multi-sector operations as significantly increasing the number of policy actions their country must deliver. Further, clients' ratings are mixed on whether multi-sector operations bring about better outcomes than single-sector operations.

World Bank Multi-sector Policy-based Operations…



Q10. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

World Bank Multi-sector Policy-based Operations…

Country Code

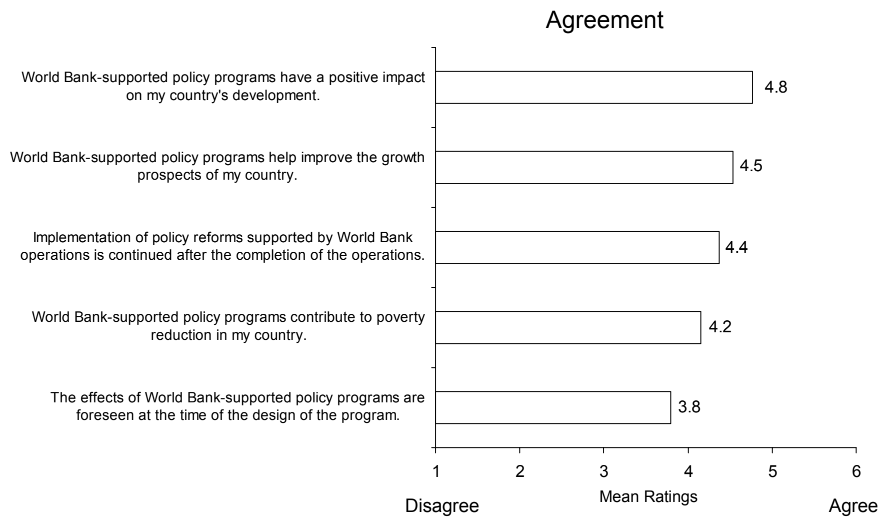
Q10.0 Multi-sector Policy Programs	Country Code truncated: Blend Mean	Blend Valid N	Core and Investment Grade IBRD Mean	Core and Investment Grade IBRD Valid N	Core IDA and LICUS Mean	Core IDA and LICUS Valid N	Table Total Mean	Table Total Valid N
WB multi-sector operations significantly increase the number of policy actions my country must deliver to obtain financial support.	4.2	N=9	4.3	N=29	4.7	N=25	4.4	N=63
WB multi-sector operations bring additional value because the feedback between the sectors improves the overall qual. of the program.	3.6	N=7	4.2	N=29	4.5	N=25	4.3	N=61
World Bank multi-sector operations are aligned with the priorities of my government.	4.0	N=9	4.1	N=28	4.4	N=26	4.2	N=63
World Bank multi-sector operations bring about better outcomes than single sector operations.	4.0	N=9	3.5	N=29	4.2	N=25	3.9	N=63

Q10. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

IMPACT AND RESULTS OF WORLD BANK-SUPPORTED POLICY PROGRAMS

Clients rate World Bank-supported policy programs high in their positive impact on their country's development and their ability to improve their country's growth prospects. Clients also rate highly the implementation of policy reforms after the completion of operations; their rating is lower on whether the policy programs contribute to poverty reduction in their country. However, one area of perceived weakness in World Bank-supported policy programs is foreseeing the effects of policy programs at the time of design of the program.

Impact and Results of World Bank-supported Policy Programs …



Q11. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Impact and Results of World Bank-supported Policy Programs …

Country Code

Q11.0 Impact and Results of World Bank-supported Policy Programs	Country Code truncated						Table Total	
	Blend		Core and Investment Grade IBRD		Core IDA and LICUS			
	Mean	Valid N	Mean	Valid N	Mean	Valid N	Mean	Valid N
World Bank-supported policy programs have a positive impact on my country's development.	4.3	N=11	4.9	N=49	4.8	N=33	4.8	N=93
World Bank-supported policy programs help improve the growth prospects of my country.	4.2	N=11	4.6	N=49	4.6	N=33	4.5	N=93
Implementation of policy reforms supported by World Bank operations is continued after the completion of the operations.	4.2	N=11	4.5	N=49	4.2	N=33	4.4	N=93
World Bank-supported policy programs contribute to poverty reduction in my country.	4.0	N=11	4.0	N=45	4.4	N=33	4.2	N=89
The effects of World Bank-supported policy programs are foreseen at the time of the design of the program.	3.6	N=11	3.9	N=47	3.8	N=32	3.8	N=90

Q11. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

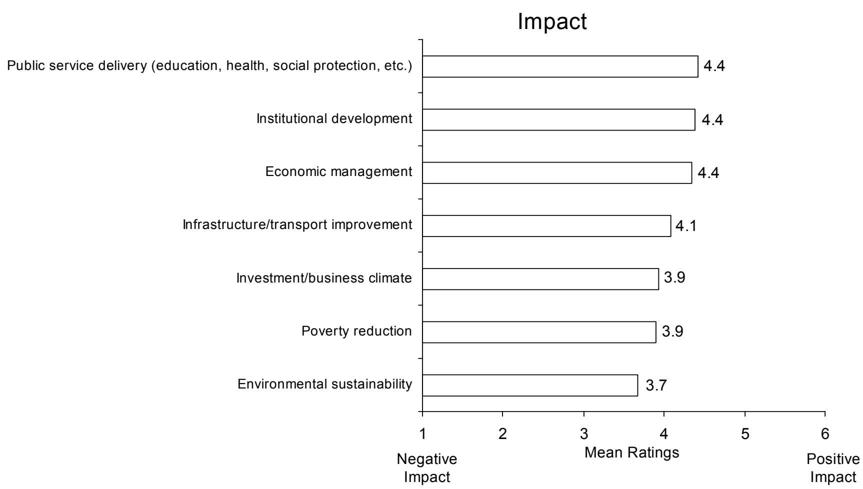
The top four areas where World Bank-supported policy programs are perceived to have the greatest *positive impact* include:

- Public service delivery (education, health, etc.)
- Institutional development
- Economic management
- Infrastructure/transport improvement

Areas where World Bank-supported policy programs received relatively low ratings included:

- Investment/business climate
- Poverty reduction
- Environmental sustainability

Impact and Results of World Bank-supported Policy Programs (Cont.)



Q12 On a 6-point scale where "6" means **positive impact** and "1" means **negative impact**, please rate the impact of World Bank-supported policy programs implemented in your country on each of the following
Source: May 2005 World Bank Conditionality Survey

Impact and Results of World Bank-supported Policy Programs (Cont.)

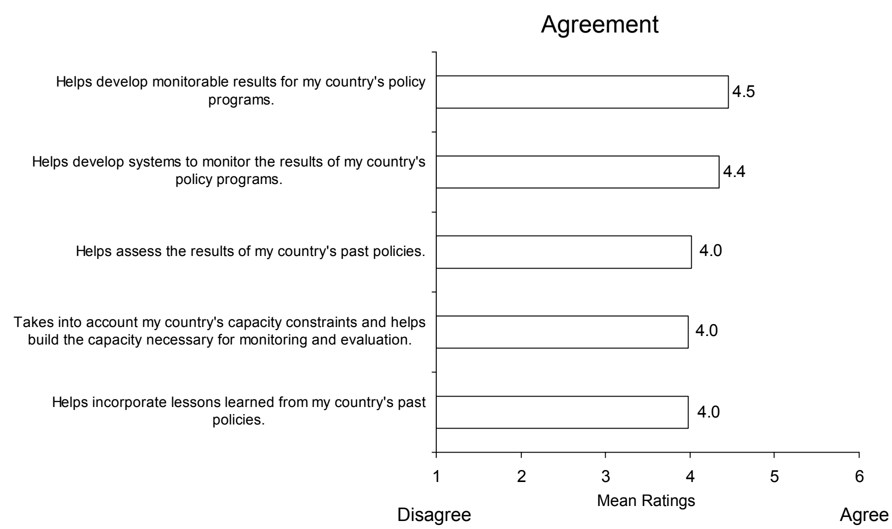
Country Code

	Country Code truncated						Table Total	
Q12.0 Negative/Positive impact	Blend		Core and Investment Grade IBRD		Core IDA and LICUS			
	Mean	Valid N	Mean	Valid N	Mean	Valid N	Mean	Valid N
Public service delivery (education, health, social protection, water, etc.)	4.7	N=11	4.3	N=47	4.5	N=32	4.4	N=90
Institutional development	4.2	N=11	4.4	N=49	4.4	N=30	4.4	N=90
Economic management	3.9	N=11	4.3	N=46	4.6	N=31	4.4	N=88
Infrastructure/transport improvement	4.5	N=10	3.9	N=46	4.2	N=32	4.1	N=88
Investment/business climate	4.1	N=10	3.9	N=48	3.9	N=31	3.9	N=89
Poverty reduction	4.2	N=11	3.6	N=46	4.2	N=32	3.9	N=89
Environmental sustainability	4.1	N=11	3.7	N=45	3.5	N=31	3.7	N=87

Q12 On a 6-point scale where "6" means **positive impact** and "1" means **negative impact**, please rate the impact of World Bank-supported policy programs implemented in your country on each of the following
Source: May 2005 World Bank Conditionality Survey

Clients rate the World Bank high on helping their country develop monitorable results and systems to measure the results of policy programs. The World Bank was rated slightly lower on helping to assess the results of past policies, and still slightly lower on incorporating lessons learned from past polices, and taking into account a country's capacity constraints.

Impact and Results of World Bank-supported Policy Programs (Cont.)



Q13. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Impact and Results of World Bank-supported Policy Programs (Cont.)

Country Code

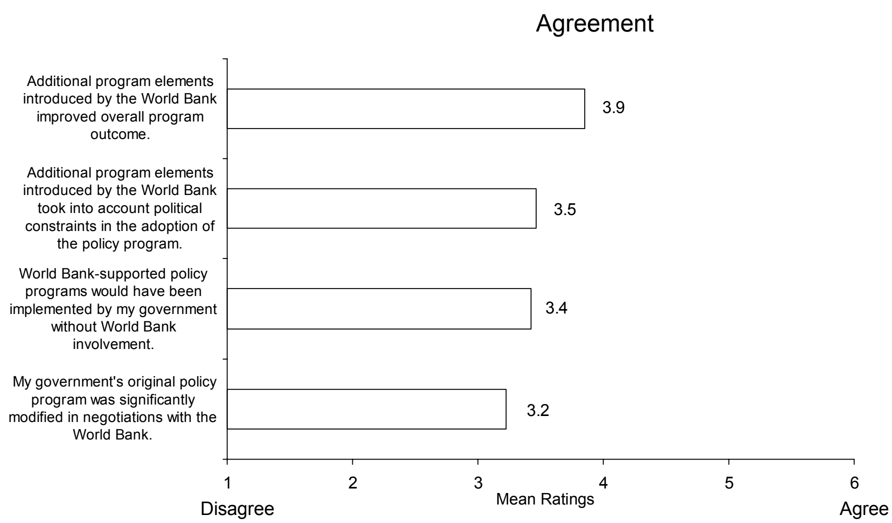
Q13.0 Impact and Results of World Bank-supported Policy Programs	Country Code truncated						Table Total	
	Blend		Core and Investment Grade IBRD		Core IDA and LICUS			
	Mean	Valid N	Mean	Valid N	Mean	Valid N	Mean	Valid N
The World Bank helps develop monitorable results for my country's policy programs.	4.1	N=11	4.6	N=46	4.4	N=32	4.5	N=89
The World Bank helps develop systems to monitor the results of my country's policy programs.	4.2	N=11	4.3	N=46	4.4	N=31	4.4	N=88
The World Bank helps assess the results of my country's past policies.	4.4	N=11	3.9	N=47	4.1	N=32	4.0	N=90
The World Bank helps incorporate lessons learned from my country's past policies.	4.3	N=11	3.9	N=47	4.0	N=32	4.0	N=90
The WB takes into account my country's capacity constraints and helps build the capacity necessary for monitoring and evaluation.	3.8	N=11	3.9	N=47	4.2	N=32	4.0	N=90

Q13. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

ADDITIONALITY OF THE POLICY ACTIONS CHOSEN AS CONDITIONS FOR WORLD BANK SUPPORT

Clients rated relatively low additional program elements introduced by the World Bank as improving overall program outcomes. Further, clients rated the World Bank low in taking political constraints into account in the adoption of policy programs. According to the rating, it is uncertain whether or not the countries would have implemented the policy program without World Bank involvement. The extent to which the government's original program was significantly modified by the World Bank differs among countries.

Additionality of the Policy Actions Chosen As Conditions of World Bank Support



Q14. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Additionality of the Policy Actions Chosen As Conditions of World Bank Support

Country Code

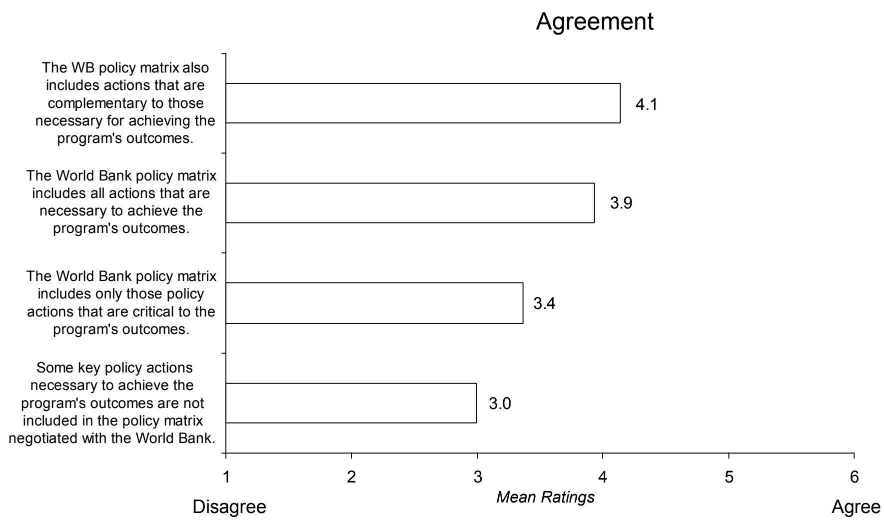
	Country Code truncated						Table Total	
Q14.0 Additionality of the Policy Actions	Blend		Core and Investment Grade IBRD		Core IDA and LICUS			
	Mean	Valid N	Mean	Valid N	Mean	Valid N	Mean	Valid N
Additional program elements introduced by the World Bank improved overall program outcome.	3.9	N=9	3.8	N=46	3.9	N=30	3.9	N=85
Additional program elements introduced by the WB took into account political constraints in the adoption of the policy program.	3.8	N=10	3.5	N=46	3.3	N=31	3.5	N=87
World Bank-supported policy programs would have been implemented by my government without World Bank involvement.	3.5	N=11	3.7	N=47	3.0	N=32	3.4	N=90
My government's original policy program was significantly modified in negotiations with the World Bank.	3.4	N=10	3.0	N=47	3.5	N=29	3.2	N=86

Q14. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

CRITICALITY OF THE POLICY ACTIONS CHOSEN AS CONDITIONS FOR WORLD BANK SUPPORT

Clients generally rate World Bank policy matrix actions high in terms of being complementary to actions necessary for achieving program outcomes, and somewhat lower in terms of including *all* actions that are necessary to achieve those outcomes. Clients, however, rate the policy matrix low in terms of including only those policy actions that are critical to the program's outcome. Some clients rated the martrices as missing policy actions that are necessary for achieving the program outcomes.

Criticality of the Policy Actions Chosen As Conditions of the World Bank Support



Q15. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Criticality of the Policy Actions Chosen As Conditions of the World Bank Support

Country Code

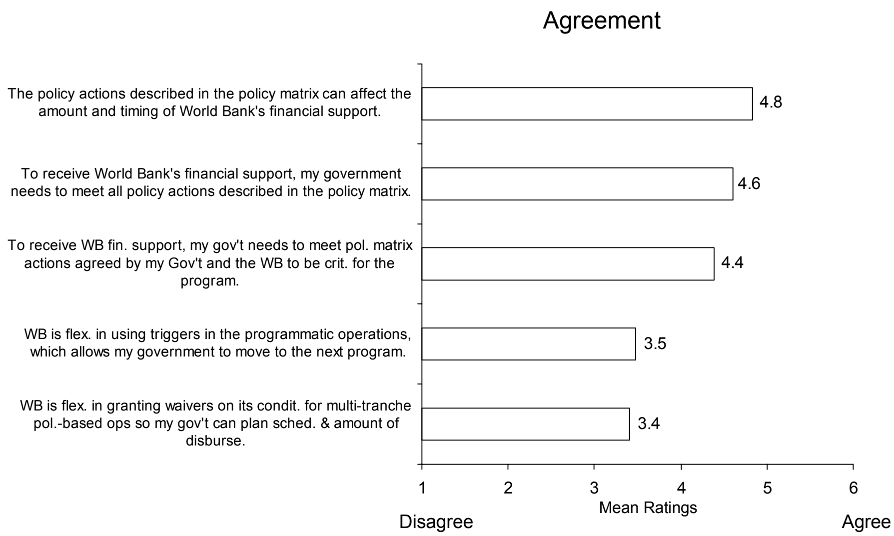
Q15.0 Criticality of the Policy Actions	Country Code truncated: Blend		Core and Investment Grade IBRD		Core IDA and LICUS		Table Total	
	Mean	Valid N	Mean	Valid N	Mean	Valid N	Mean	Valid N
The WB policy matrix also includes actions that are complementary to those necessary for achieving the program's outcomes.	4.3	N=8	4.1	N=46	4.2	N=31	4.1	N=85
The World Bank policy matrix includes all actions that are necessary to achieve the program's outcomes.	4.1	N=8	4.0	N=46	3.7	N=31	3.9	N=85
The World Bank policy matrix includes only those policy actions that are critical to the program's outcomes.	3.3	N=8	3.4	N=47	3.4	N=30	3.4	N=85
Some key policy actions necessary to achieve the program's outcomes are not included in the policy matrix negotiated with the WB.	3.3	N=8	2.9	N=45	3.0	N=28	3.0	N=81

Q15. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

PREDICTABILITY OF WORLD BANK SUPPORT

There is a distinct perception among clients that their governments must meet *all* policy actions described in the policy matrix in order to receive World Bank financial support. Clients strongly rate the actions included in the matrix as having the ability to affect whether World Bank support is received, and if so, the amount and timing of that support. Finally, the World Bank received low ratings regarding the flexibility in using triggers on programmatic operations and granting waivers in multi-tranche operations.

Predictability of World Bank Support



Q16. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Predictability of World Bank Support

Country Code

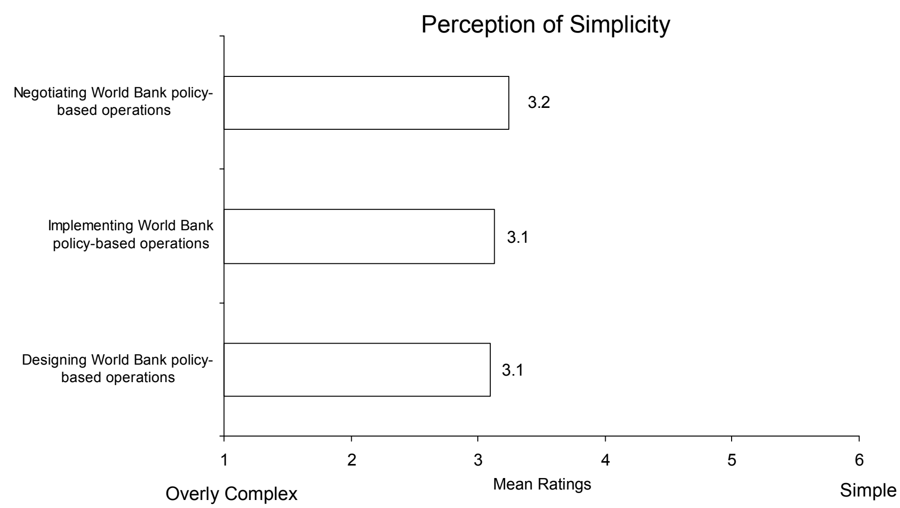
Q16.0 Predictability of World Bank Support	Country Code truncated: Blend Mean	Blend Valid N	Core and Investment Grade IBRD Mean	Core and Investment Grade IBRD Valid N	Core IDA and LICUS Mean	Core IDA and LICUS Valid N	Table Total Mean	Table Total Valid N
The policy actions described in the policy matrix can affect the amount and timing of World Bank's financial support.	5.1	N=9	4.6	N=45	5.0	N=30	4.8	N=84
To receive World Bank's financial support, my government needs to meet all policy actions described in the policy matrix.	4.8	N=9	4.6	N=45	4.6	N=32	4.6	N=86
To receive WB fin. support, my gov't needs to meet pol. matrix actions agreed by my Gov't and the WB to be crit. for the program.	5.1	N=9	4.0	N=44	4.8	N=32	4.4	N=85
WB is flex. in using triggers in the programmatic operations, which allows my government to move to the next program.	3.3	N=9	3.5	N=41	3.5	N=29	3.5	N=79
WB is flex. in granting waivers on its condit. for multi-tranche pol.-based ops so my gov't can plan sched. & amount of disburse.	3.1	N=9	3.4	N=43	3.5	N=30	3.4	N=82

Q16. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

NEGOTIATING AND IMPLEMENTING WORLD BANK POLICY-BASED OPERATIONS AND SIGNIFICANT CHALLENGES TO THE GOVERNMENTS

Clients generally rate doing business with the World Bank as complex. Specifically, ratings are consistently weighted toward overly complex when doing business with the World Bank with respect to designing, negotiating, and implementing policy-based operations.

Negotiating and Implementing the World Bank Policy-based Operations



Q17. On a six-point scale where "6" means **simple** and "1" means **overly complex**, how would you rate doing business with the World Bank with respect to:
Source: May 2005 World Bank Conditionality Survey

Negotiating and Implementing the World Bank Policy-based Operations

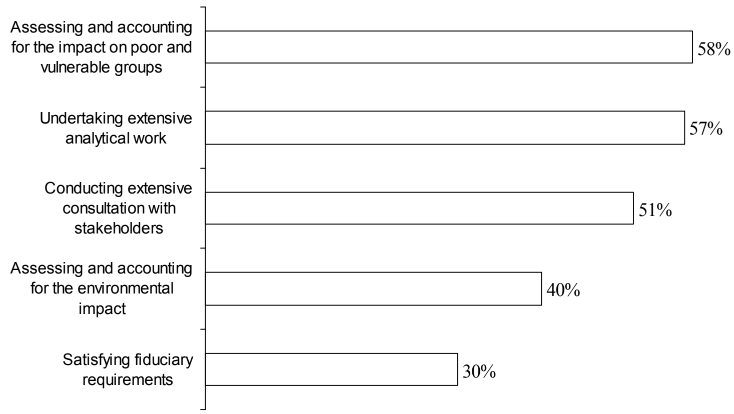
Country Code

Q17.0 Perception of Simplicity	Country Code truncated: Blend		Core and Investment Grade IBRD		Core IDA and LICUS		Table Total	
	Mean	Valid N	Mean	Valid N	Mean	Valid N	Mean	Valid N
Negotiating World Bank policy-based operations	3.1	N=10	3.3	N=46	3.2	N=30	3.2	N=86
Implementing World Bank policy-based operations	2.9	N=10	3.1	N=47	3.3	N=30	3.1	N=87
Designing World Bank policy-based operations	3.3	N=10	3.1	N=46	3.0	N=30	3.1	N=86

Q17. On a six-point scale where "6" means simple and "1" means overly complex, how would you rate doing business with the World Bank with respect to:
Source: May 2005 World Bank Conditionality Survey

Clients view as the most significant challenges to their government in World Bank operations the following: assessing and accounting for the impact on poor and vulnerable groups, undertaking extensive analytical work, and conducting extensive consultations with stakeholders. Clients rated much lower the challenge posed by satisfying fiduciary requirements.

Significant Challenges to Government Relation to World Bank Operations



Q18. In your view, which of the following constitute significant challenges for your Government in relation to World Bank operations? (Select all that apply)
Source: May 2005 World Bank Conditionality Survey

Significant Challenges to Government Relation to World Bank Operations

Country Code

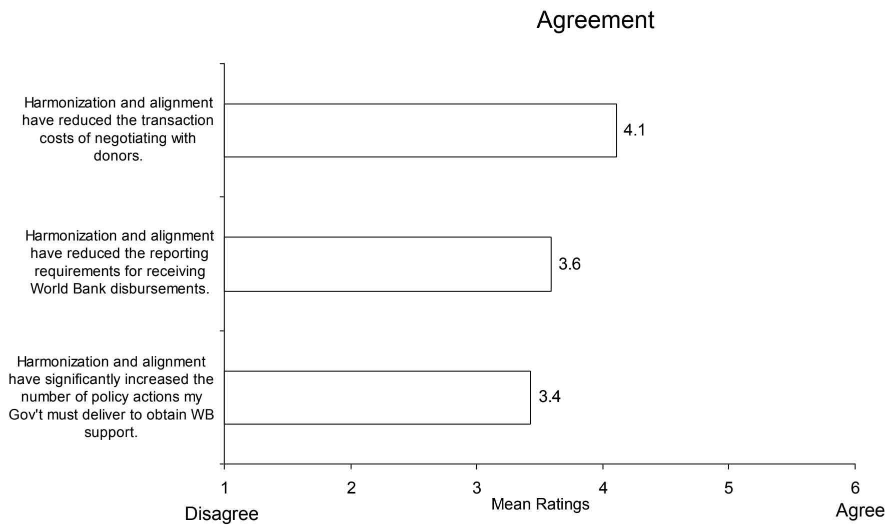
Q.18 Significant challange:	Country Code truncated Blend	 Core and Investment Grade	 Core IDA and LICUS	Table Total
	Col %	Col %	Col %	Col %
Assessing and accounting for the impact on poor and vulnerable groups	78%	42%	75%	58%
Undertaking extensive analytical work	44%	60%	56%	57%
Conducting extensive consultation with stakeholders	33%	62%	41%	51%
Assessing and accounting for the environmental impact	44%	40%	38%	40%
Satisfying fiduciary requirements	33%	22%	41%	30%
Valid count	**12**	**56**	**37**	**105**

Q18. In your view, which of the following constitute significant challenges for your Government in relation to World Bank operations? (Select all that apply)
Source: May 2005 World Bank Conditionality Survey

HARMONIZATION AND ALIGNMENT AMONG EXTERNAL DEVELOPMENT PARTNERS

Client ratings of harmonization and alignment initiatives are mixed. Clients rate somewhat high the harmonization and alignment initiatives focused on reducing transaction costs of negotiating. Also, clients rate low the contribution of harmonization to increasing the number of policy actions that client government's must delivery to obtain World Bank support. However, harmonization and alignment initiatives focused on reducing reporting requirements are rated low.

Harmonization and Alignment Among External Development Partners



Q20. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Harmonization and Alignment Among External Development Partners

Country Code

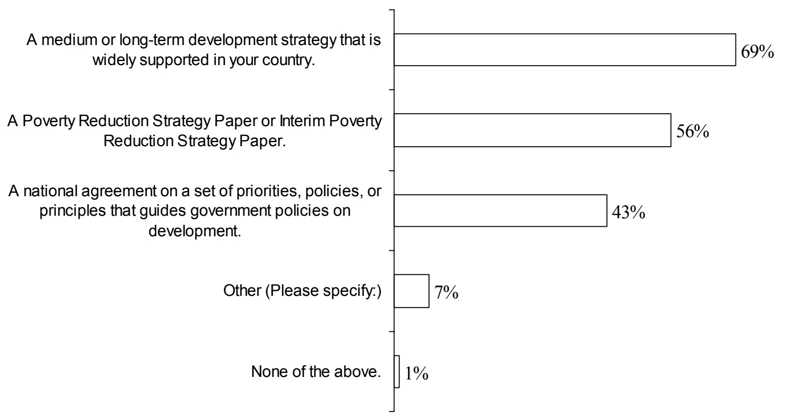
Q20.0 Harmonization and Alignment	Country Code truncated						Table Total	
	Blend		Core and Investment Grade IBRD		Core IDA and LICUS			
	Mean	Valid N	Mean	Valid N	Mean	Valid N	Mean	Valid N
Harmonization and alignment have reduced the transaction costs of negotiating with donors.	4.7	N=10	3.9	N=46	4.2	N=29	4.1	N=85
Harmonization and alignment have reduced the reporting requirements for receiving World Bank disbursements.	4.3	N=9	3.5	N=44	3.5	N=29	3.6	N=82
Harmonization and alignment have significantly increased the number of policy actions my Gov't must deliver to obtain WB support.	4.5	N=8	3.3	N=44	3.4	N=28	3.4	N=80

Q20. On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Detailed Survey Results

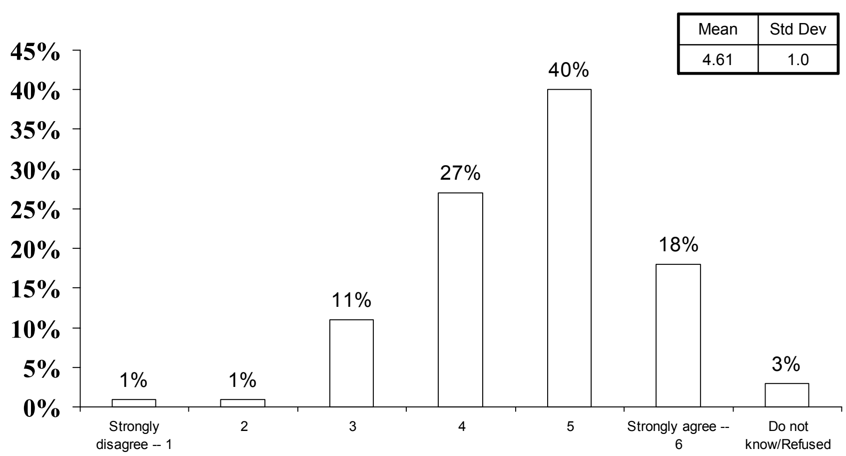
MEDIUM- AND LONG-TERM POLICY FRAMEWORK

Country Medium and Long-term Development Strategy



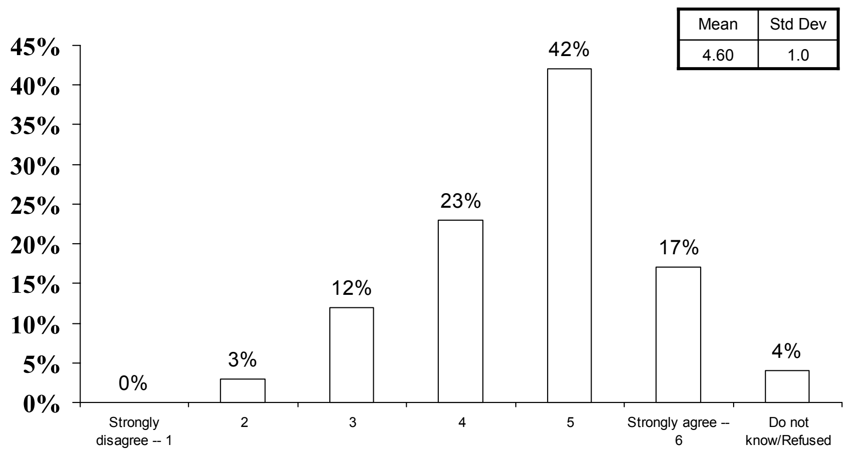
Q4. Which of the following does your country have?
Source: May 2005 World Bank Conditionality Survey

World Bank-supported policy programs are well aligned with my country's medium and long-term development strategy



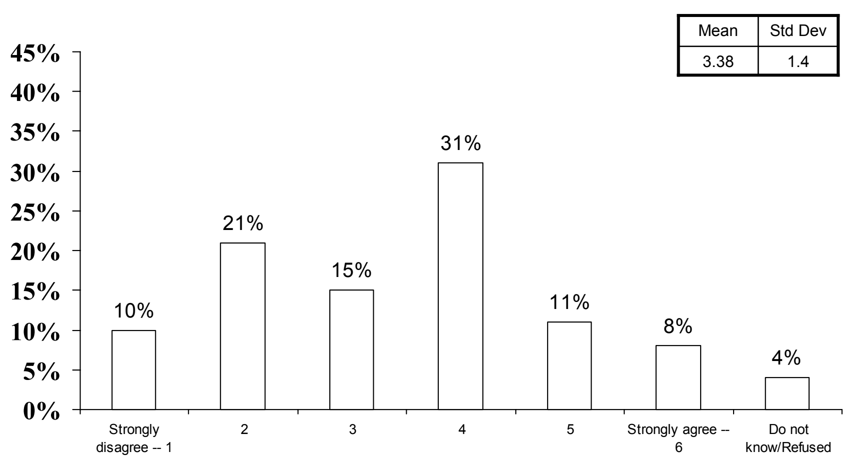
Q5.1 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

The World Bank's participation helps my Government focus on policy actions that support the implementation of my country's medium and long-term development strategy



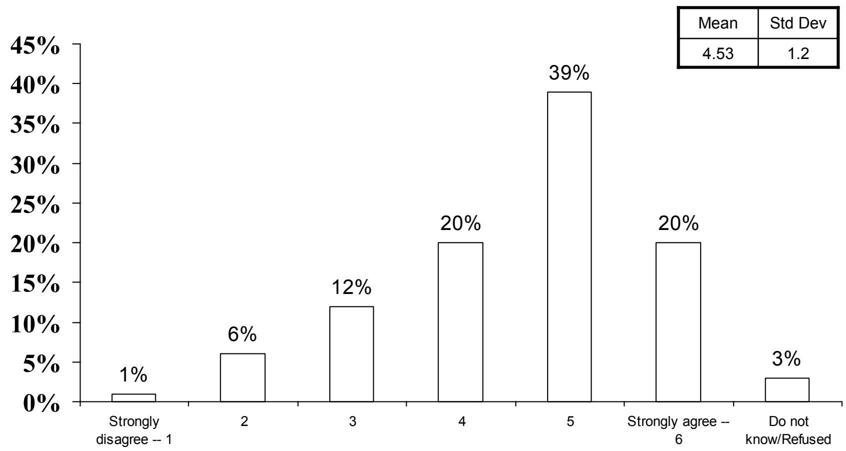
Q5.2 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

World Bank-supported policy programs introduce new elements that are not part of my country's medium and long-term development strategy



Q5.3 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

The World Bank helps develop my country's medium and long-term development strategy through policy dialogue and joint analytical work



Q5.4 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

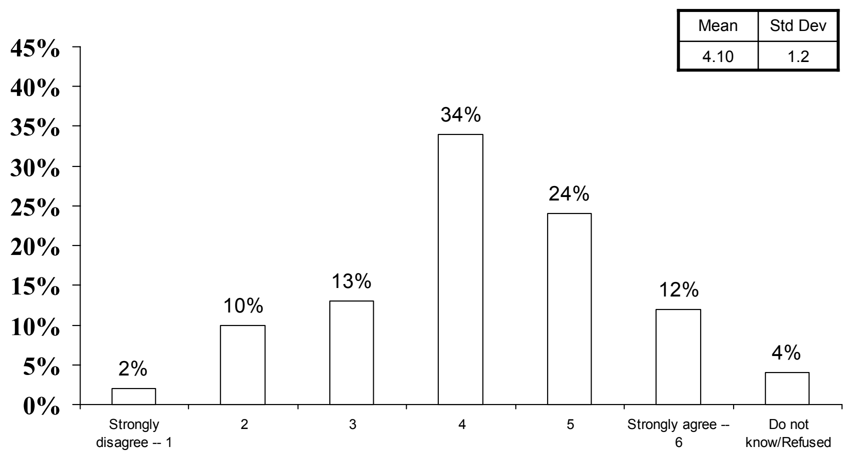
Rating Summary: Medium and Long-Term Policy Framework

Q5 World Bank-support policy programs	Mean	Std Deviation	Valid N
5.1 World Bank-supported policy programs are well aligned with my country's medium and long-term development strategy.	4.61	1.0	N=98
5.2 The WB's partic. helps my Gov't focus on policy actions that support implementation of my country's med. and long-term dev. strategy.	4.60	1.0	N=97
5.3 WB-supported policy programs introduce new elements that are not part of my country's medium and long-term development strategy.	3.38	1.4	N=96
5.4 The WB helps develop my country's medium and long-term development strategy through policy dialogue and joint analytical work.	4.53	1.2	N=98

Source: May 2005 World Bank Conditionality Survey

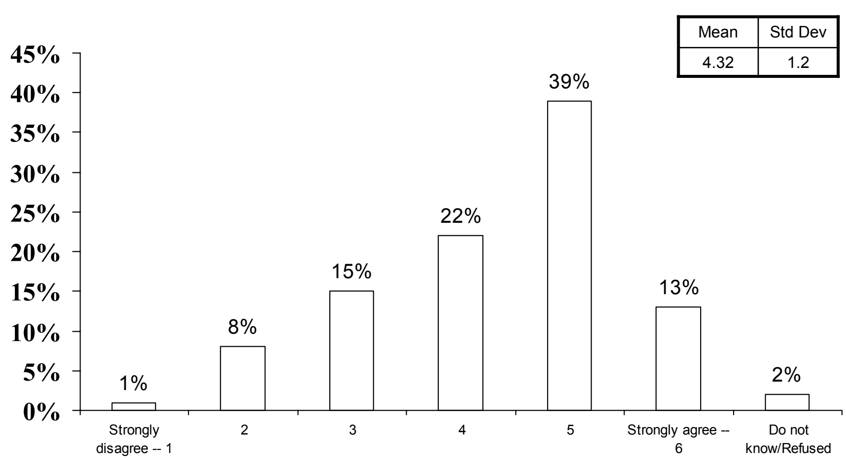
OWNERSHIP OF THE POLICY PROGRAMS SUPPORTED BY THE WORLD BANK

There is a strong sense of ownership of World Bank-supported policy programs in my country



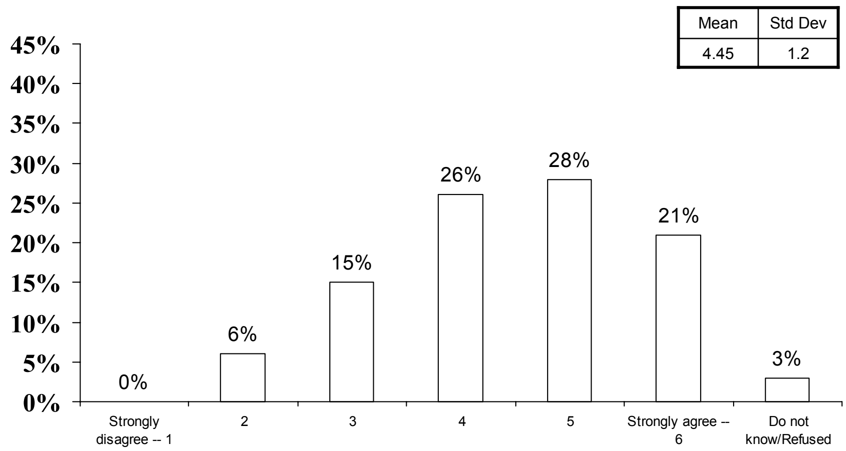
Q6.1 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

World Bank-supported policy programs have sufficient political support within my country



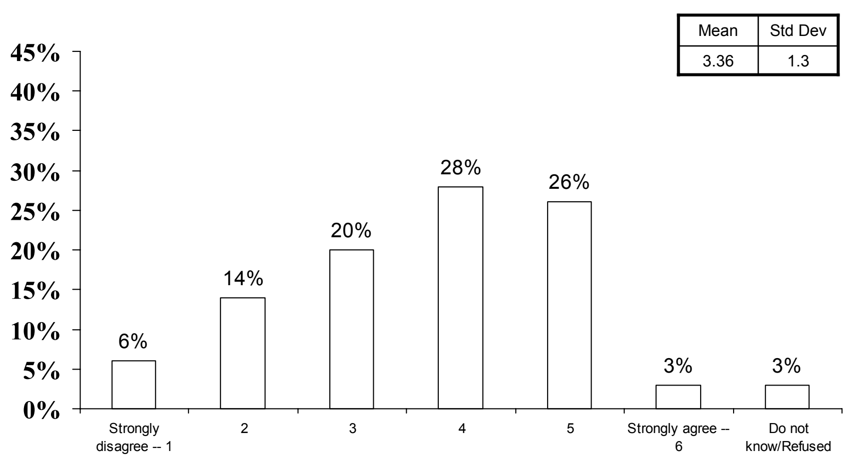
Q6.2 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

World Bank-supported policy programs are crucial for the achievement of my country's medium and long-term development strategy



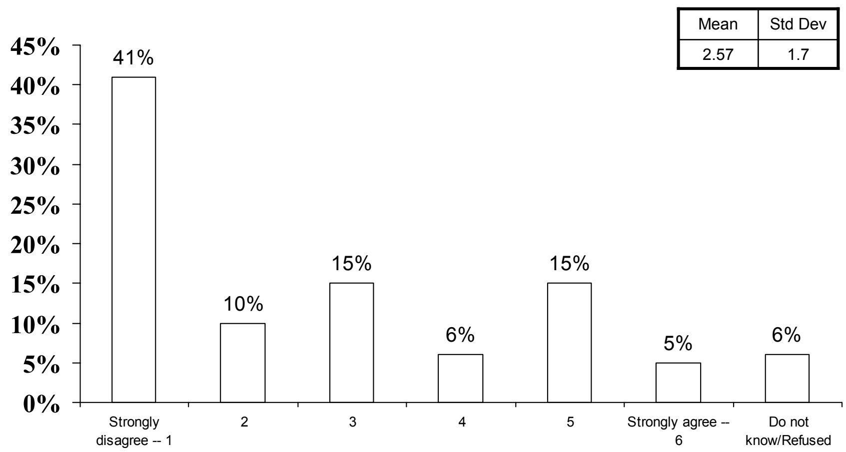
Q6.3 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

World Bank-supported policy programs take into consideration political constraints faced by my Government



Q6.4 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

My country was in crisis and had to agree with the World Bank on a policy program that was not widely owned by my country



Q6.5 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

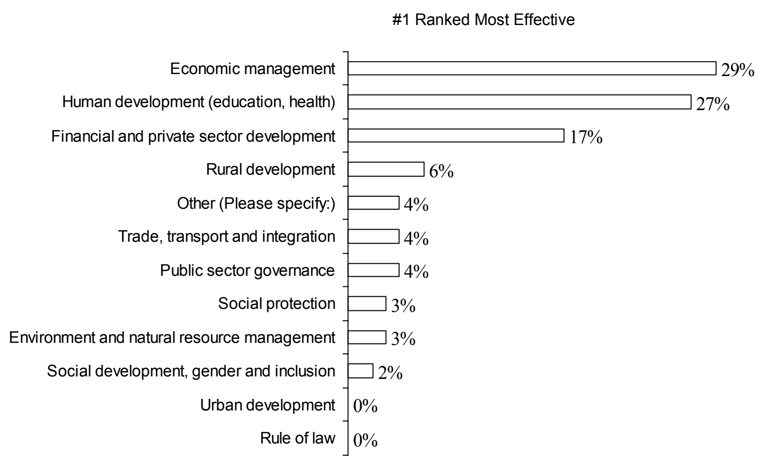
Rating Summary: Ownership of the Policy Programs Supported by the World Bank

Q6 Ownership of policy programs	Mean	Std Deviation	Valid N
6.1 There is a strong sense of ownership of World Bank-supported policy programs in my country.	4.10	1.2	N=94
6.2 World Bank-supported policy programs have sufficient political support within my country.	4.32	1.2	N=98
6.3 World Bank-supported policy programs are crucial for the achievement of my country's medium and long-term development strategy.	4.45	1.2	N=96
6.4 World Bank-supported policy programs take into consideration political constraints faced by my Government.	3.63	1.3	N=95
6.5 My country was in crisis and had to agree with the World Bank on a policy program that was not widely owned by my country.	2.57	1.7	N=91

Source: May 2005 World Bank Conditionality Survey

CONTENT OF WORLD BANK-SUPPORTED PROGRAMS

Areas of World Bank Involvement Where *Most* Effective



Q7 Please rank the **three** areas in which the World Bank's involvement has been ***most*** effective in your country (1 being the highest) within the following policy areas:
Source: May 2005 World Bank Conditionality Survey

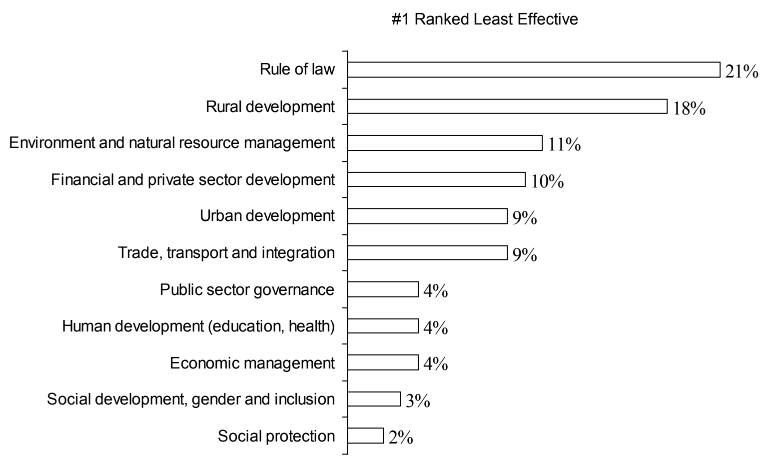
How Areas of Effective World Bank Involvement Has Been Effective

Top 3 Ranked Areas

Ways most effective:	1. Economic management	2. Human development (education, health)	3. Financial and private sector development
Sharing cross-country experience	67%	**59%**	**76%**
Tailoring analytical work to country circumstances	**70%**	**56%**	**76%**
Assessing the impact on the poor and vulnerable	52%	**56%**	12%
Assessing the impact on environment	11%	11%	12%
Alerting the government to important actions that were not foreseen in its original policy program	44%	30%	29%
Detailing/sequencing the implementation steps in the policy matrix	37%	**41%**	**47%**
Developing medium-term results framework	**63%**	**48%**	24%
Other	4%	11%	6%
	N= 27	N= 27	N= 17

Q7a. In what ways has the World Bank's involvement been ***most*** effective?
Source: May 2005 World Bank Conditionality Survey

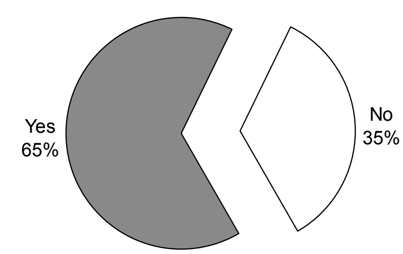
Areas of World Bank Involvement Where *Least* Effective



Q8. Please rank the **three** areas in which the World Bank's involvement has been ***least*** effective in your country within the following policy areas:
Source: May 2005 World Bank Conditionality Survey

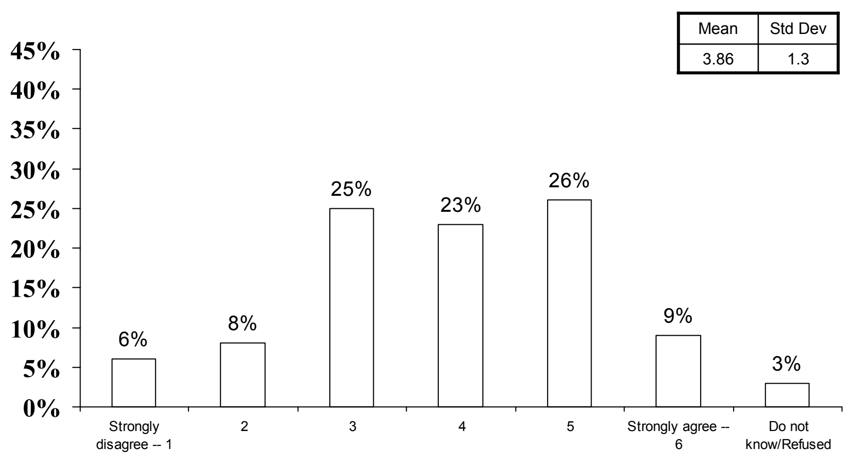
MULTI-SECTOR WORLD BANK-SUPPORTED POLICY PROGRAMS

Incidence of in the World Bank Multi-sector Policy-based Operations Involvement



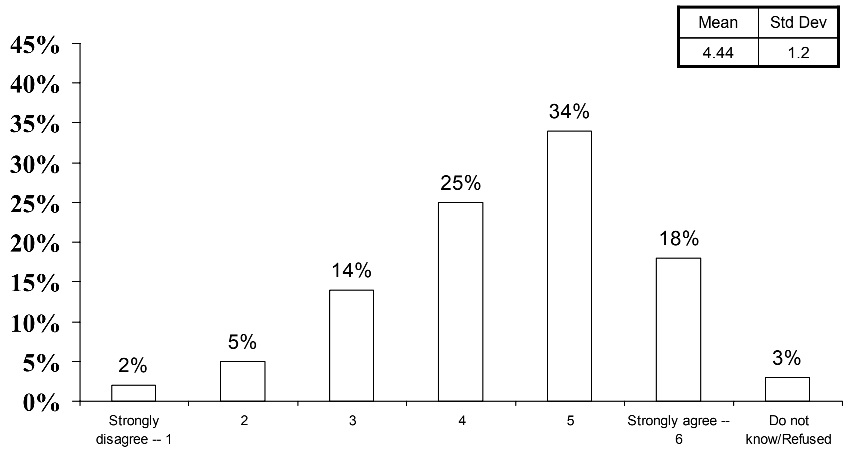
Q9. Have you been involved in the World Bank multi-sector policy-based operations?
Source: May 2005 World Bank Conditionality Survey

World Bank multi-sector operations bring about better outcomes than single sector operations



Q10.1 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

World Bank multi-sector operations significantly increase the number of policy actions my country must deliver to obtain financial support



Q10.4 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

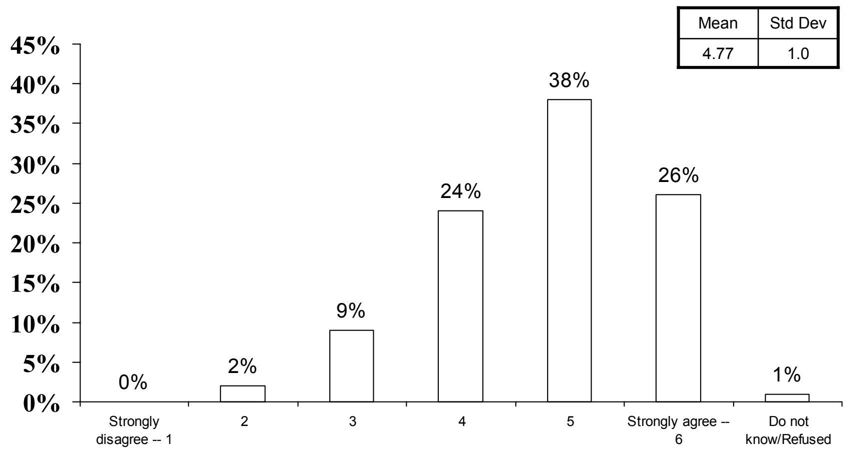
Rating Summary: Multi-Sector World Bank-Supported Policy Programs

Q10 Multi-sector World Bank-supported policy programs	Mean	Std Deviation	Valid N
10.1 World Bank multi-sector operations bring about better outcomes than single sector operations.	3.86	1.3	N=63
10.2 World Bank multi-sector operations are aligned with the priorities of my government.	4.22	0.9	N=63
10.3 WB multi-sector operations bring additional value because the feedback between the sectors improves the overall qual. of the program.	4.28	1.1	N=61
10.4 WB multi-sector operations significantly increase the number of policy actions my country must deliver to obtain financial support.	4.44	1.2	N=63

Source: May 2005 World Bank Conditionality Survey

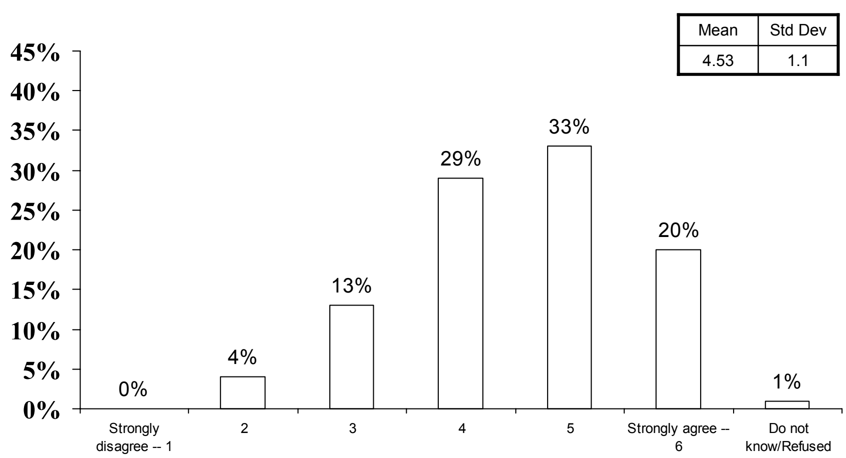
IMPACT AND RESULTS FOCUS OF WORLD BANK-SUPPORTED POLICY PROGRAMS

World Bank-supported policy programs have a positive impact on my country's development



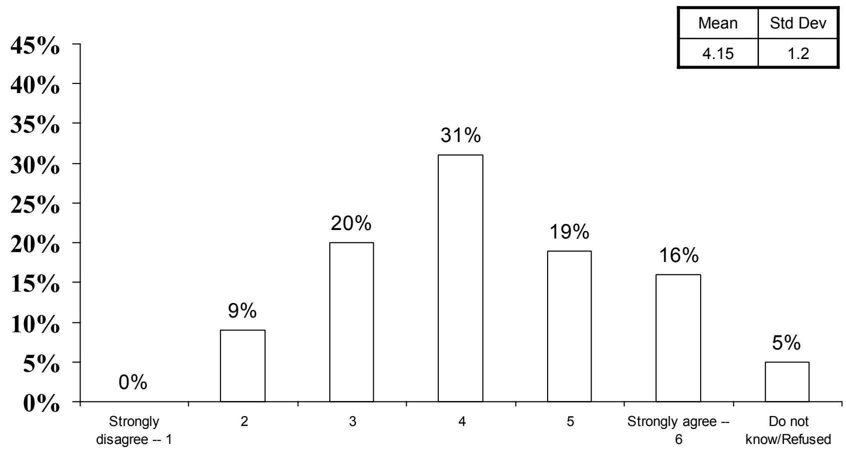
Q11.1 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

World Bank-supported policy programs help improve the growth prospects of my country



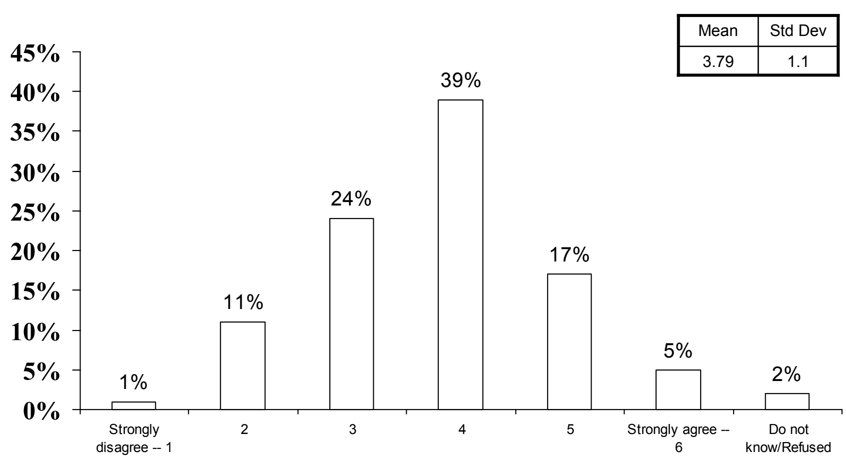
Q11.2 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

World Bank-supported policy programs contribute to poverty reduction in my country



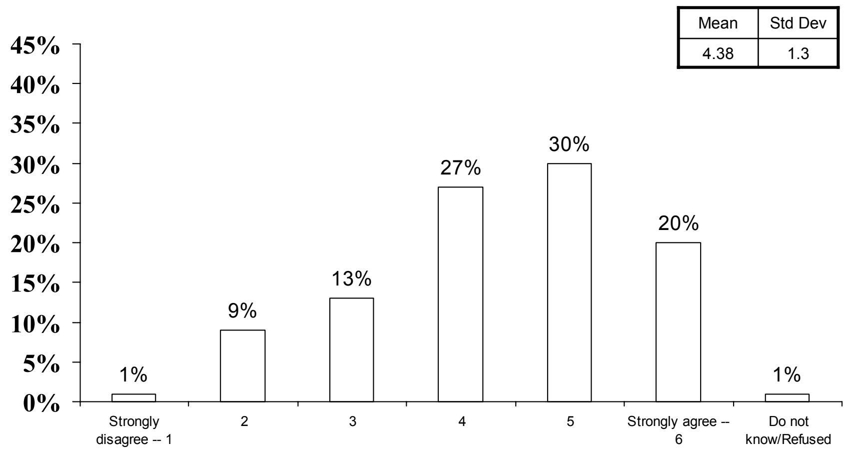
Q11.3 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

The effects of World Bank-supported policy programs are foreseen at the time of the design of the program



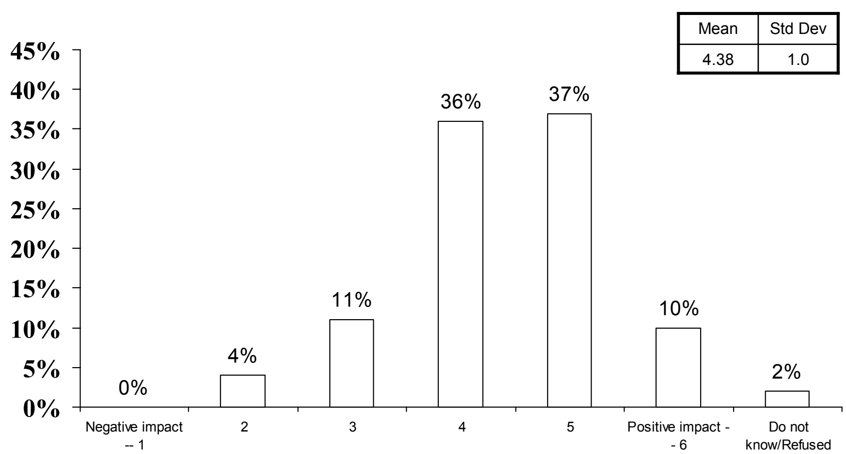
Q11.4 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Implementation of policy reforms supported by World Bank operations are continued after the completion of the operations



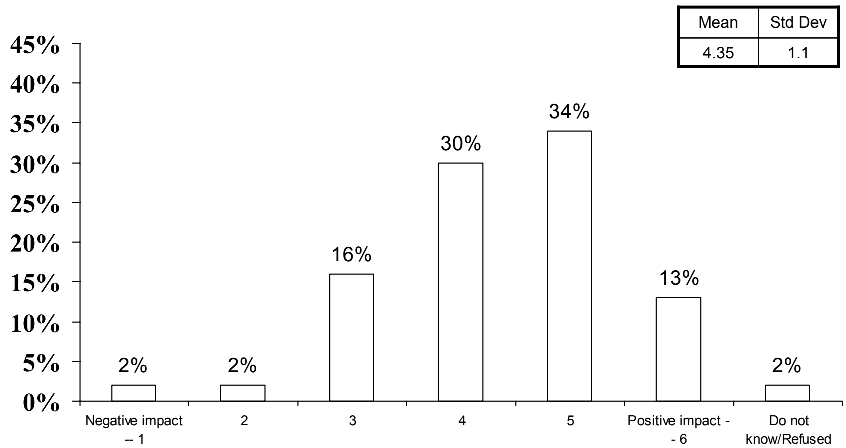
Q11.5 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Institutional development



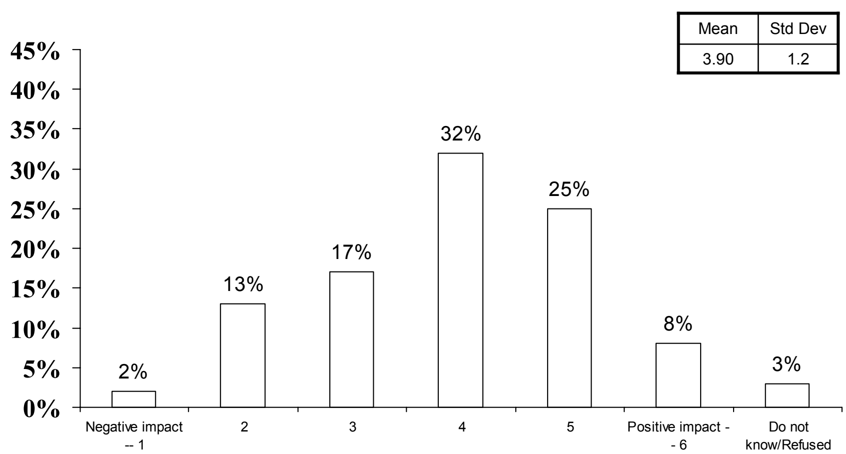
Q12.1 On a 6-point scale where "6" means **positive impact** and "1" means **negative impact**, please rate the impact of World Bank-supported policy programs implemented in your country on each of the following
Source: May 2005 World Bank Conditionality Survey

Economic management



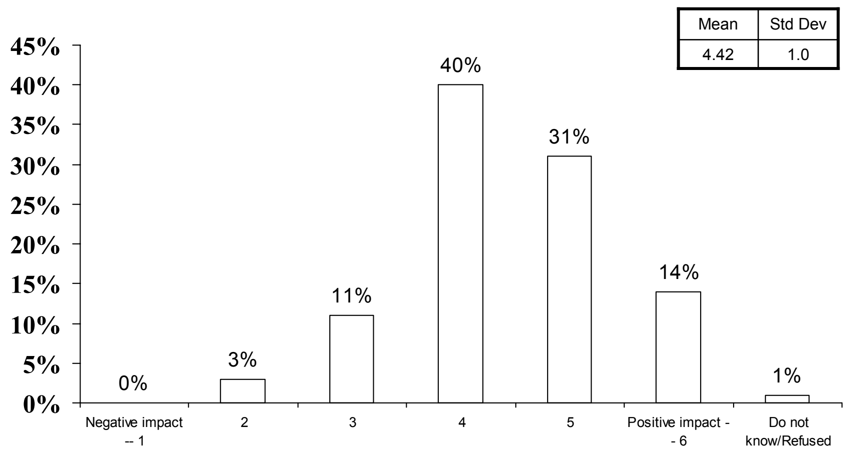
Q12.2 On a 6-point scale where "6" means **positive impact** and “1” means **negative impact**, please rate the impact of World Bank-supported policy programs implemented in your country on each of the following
Source: May 2005 World Bank Conditionality Survey

Poverty Reduction



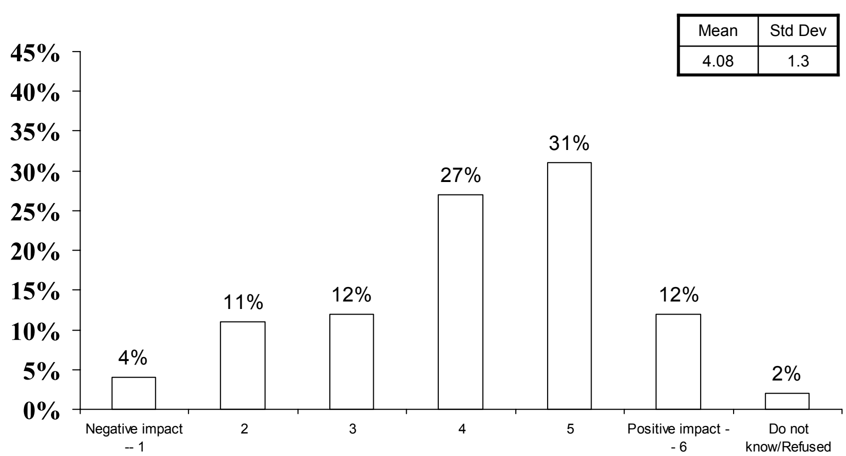
Q12.3 On a 6-point scale where "6" means **positive impact** and “1” means **negative impact**, please rate the impact of World Bank-supported policy programs implemented in your country on each of the following
Source: May 2005 World Bank Conditionality Survey

Public service delivery (education, health, social protection, water, etc.)



Q12.4 On a 6-point scale where "6" means **positive impact** and “1” means **negative impact**, please rate the impact of World Bank-supported policy programs implemented in your country on each of the following
Source: May 2005 World Bank Conditionality Survey

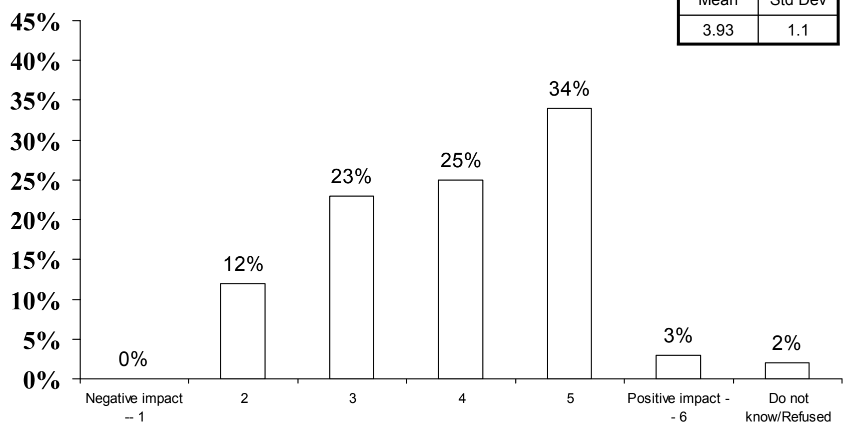
Infrastructure/transport improvement



Q12.5 On a 6-point scale where "6" means **positive impact** and “1” means **negative impact**, please rate the impact of World Bank-supported policy programs implemented in your country on each of the following
Source: May 2005 World Bank Conditionality Survey

Investment/business climate

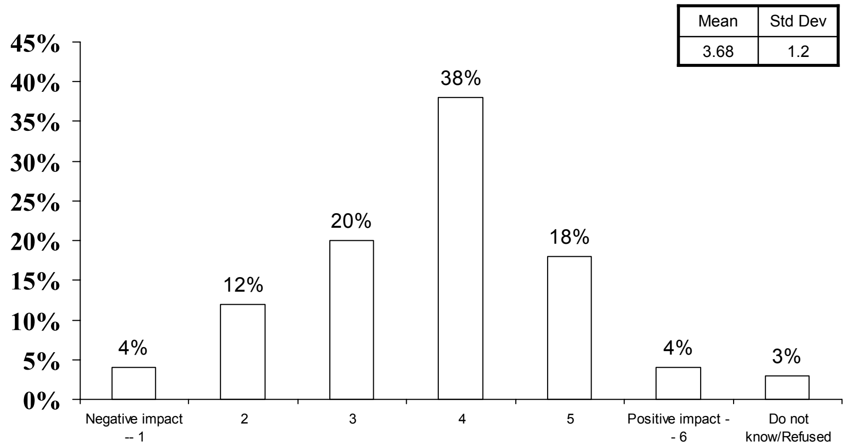
Mean	Std Dev
3.93	1.1



Q12.6 On a 6-point scale where "6" means **positive impact** and "1" means **negative impact**, please rate the impact of World Bank-supported policy programs implemented in your country on each of the following
Source: May 2005 World Bank Conditionality Survey

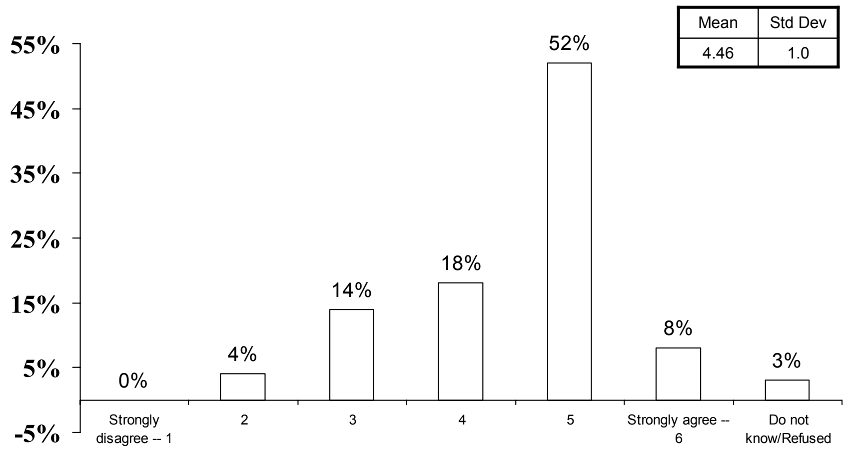
Environmental sustainability

Mean	Std Dev
3.68	1.2



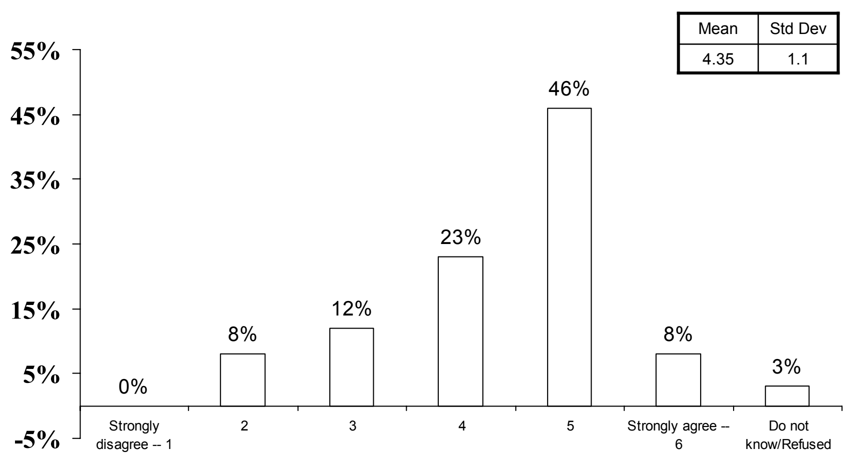
Q12.7 On a 6-point scale where "6" means **positive impact** and "1" means **negative impact**, please rate the impact of World Bank-supported policy programs implemented in your country on each of the following
Source: May 2005 World Bank Conditionality Survey

The World Bank helps develop monitorable results for my country's policy programs



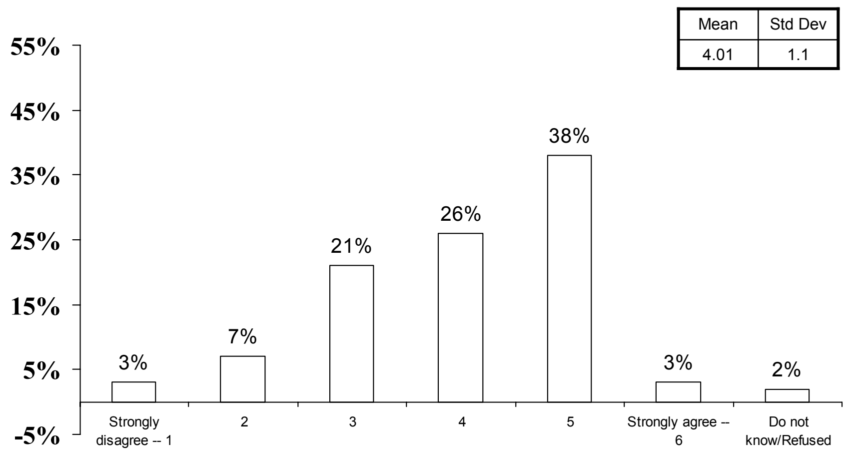
Q13.1 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

The World Bank helps develop systems to monitor the results of my country's policy programs



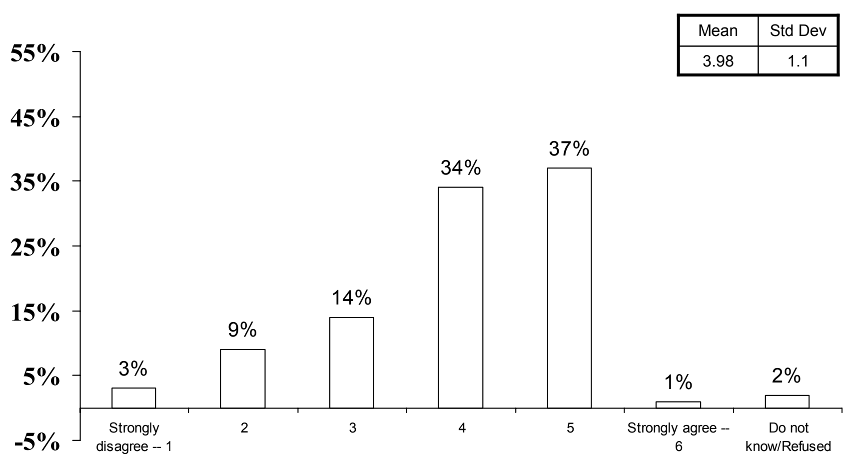
Q13.2 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

The World Bank helps assess the results of my country's past policies



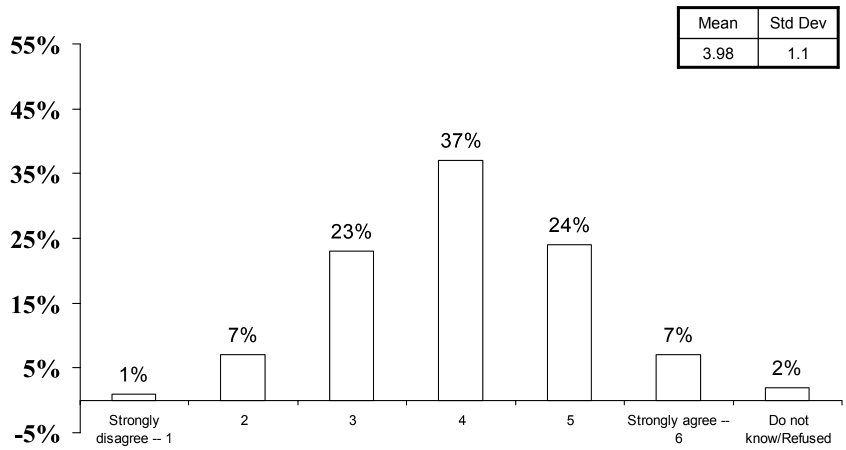
Q13.3 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

The World Bank helps incorporate lessons learned from my country's past policies



Q13.4 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

In addressing past policies, the World Bank takes into account my country's capacity constraints and helps build the capacity necessary for monitoring and evaluation



Q13.5 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

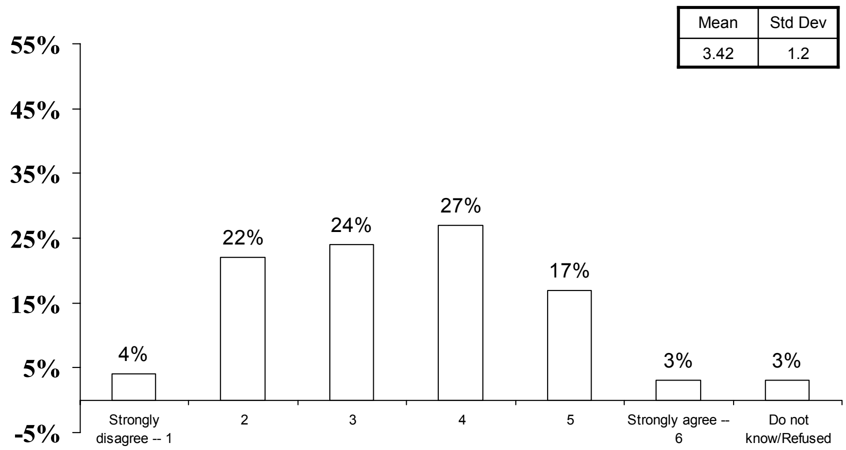
Rating Summary: Impact and Results Focus of World Bank-Supported Policy Programs

Q11 - Q13: Impact and results focus of WB-supported policy programs	Mean	Std Deviation	Valid N
11.1 World Bank-supported policy programs have a positive impact on my country's development.	4.77	1.0	N=93
11.2 World Bank-supported policy programs help improve the growth prospects of my country.	4.53	1.1	N=93
11.3 World Bank-supported policy programs contribute to poverty reduction in my country.	4.15	1.2	N=89
11.4 The effects of World Bank-supported policy programs are foreseen at the time of the design of the program.	3.79	1.1	N=90
11.5 Implementation of policy reforms supported by World Bank operations is continued after the completion of the operations.	4.38	1.3	N=93
12.1 Institutional development	4.38	1.0	N=90
12.2 Economic management	4.35	1.1	N=88
12.3 Poverty reduction	3.90	1.2	N=89
12.4 Public service delivery (education, health, social protection, water, etc.)	4.42	1.0	N=90
12.5 Infrastructure/transport improvement	4.08	1.3	N=88
12.6 Investment/business climate	3.93	1.1	N=89
12.7 Environmental sustainability	3.68	1.2	N=87
13.1 The World Bank helps develop monitorable results for my country's policy programs.	4.46	1.0	N=89
13.2 The World Bank helps develop systems to monitor the results of my country's policy programs.	4.35	1.1	N=88
13.3 The World Bank helps assess the results of my country's past policies.	4.01	1.1	N=90
13.4 The World Bank helps incorporate lessons learned from my country's past policies.	3.98	1.1	N=90
13.5 The WB takes into account my country's capacity constraints and helps build the capacity necessary for monitoring and evaluation.	3.98	1.1	N=90

Source: May 2005 World Bank Conditionality Survey

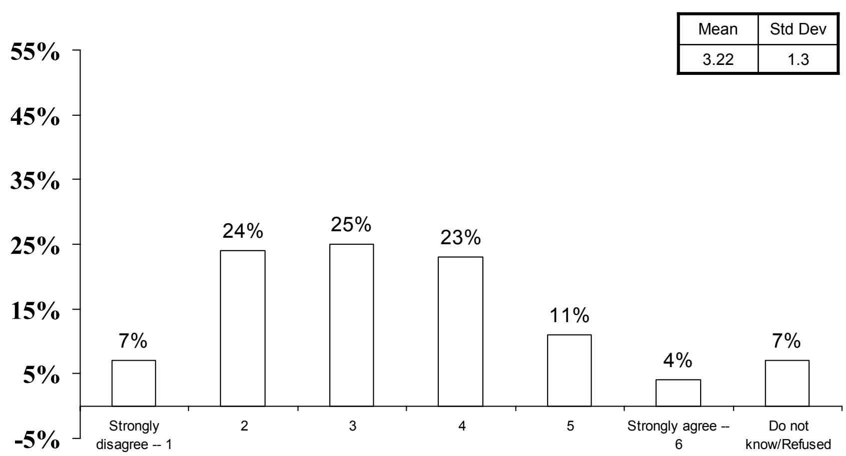
ADDITIONALITY OF THE POLICY ACTIONS CHOSEN AS CONDITIONS OF THE WORLD BANK SUPPORT

World Bank-supported policy programs would have been implemented by my government without World Bank involvement



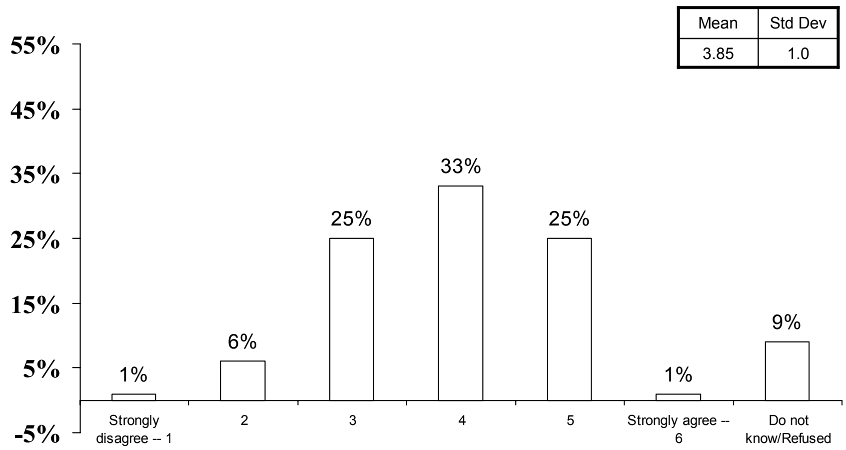
Q14.1 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

My government's original policy program was significantly modified in negotiations with the World Bank



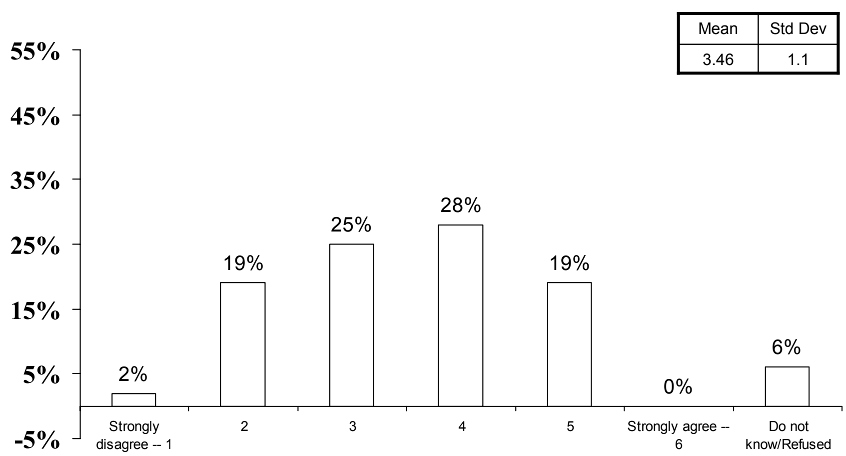
Q14.2 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Additional program elements introduced by the World Bank improved overall program outcome



Q14.3 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Additional program elements introduced by the World Bank took into account political constraints in the adoption of the policy program



Q14.4 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

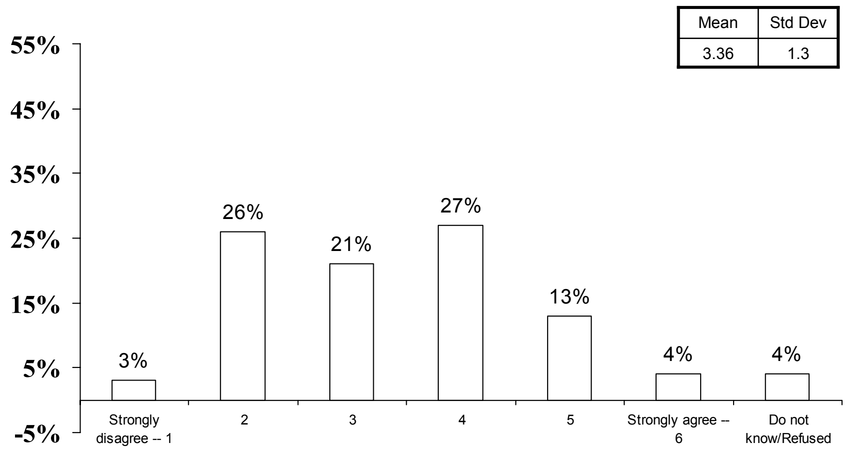
Rating Summary: Additionality of the Policy Actions Chosen As Conditions of the World Bank Support

Q14. Additionality	Mean	Std Deviation	Valid N
14.1 World Bank-supported policy programs would have been implemented by my government without World Bank involvement.	3.42	1.2	N=90
14.2 My government's original policy program was significantly modified in negotiations with the World Bank.	3.22	1.3	N=86
14.3 Additional program elements introduced by the World Bank improved overall program outcome.	3.85	1.0	N=85
14.4 Additional program elements introduced by the WB took into account political constraints in the adoption of the policy program.	3.46	1.1	N=87

Source: May 2005 World Bank Conditionality Survey

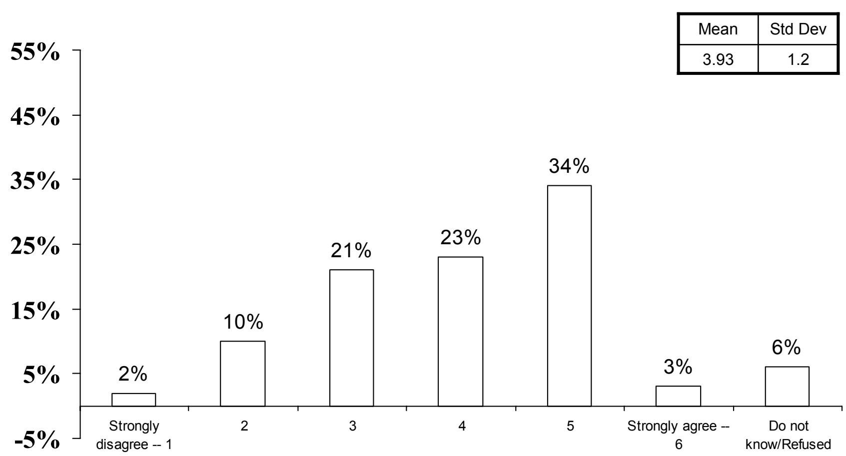
CRITICALITY OF THE POLICY ACTIONS CHOSEN AS CONDITIONS OF THE WORLD BANK SUPPORT

*The World Bank policy matrix includes only those policy actions that are **critical** to the program's outcomes*



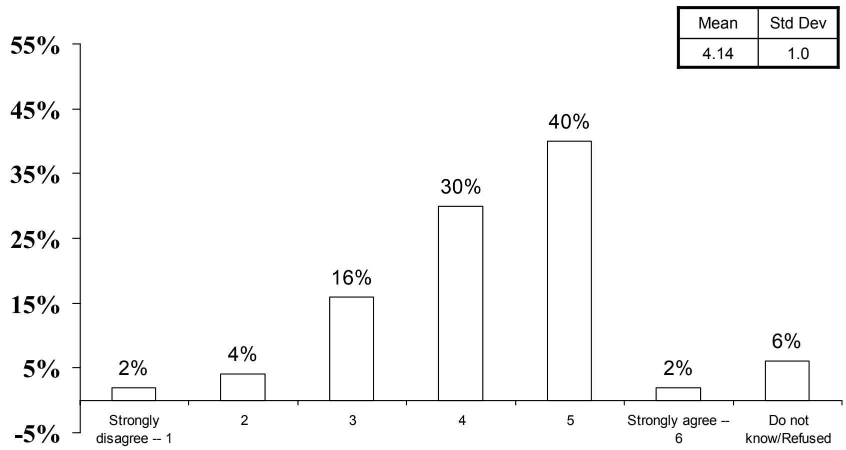
Q15.1 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

*The World Bank policy matrix includes all actions that are **necessary** to achieve the program's outcomes*



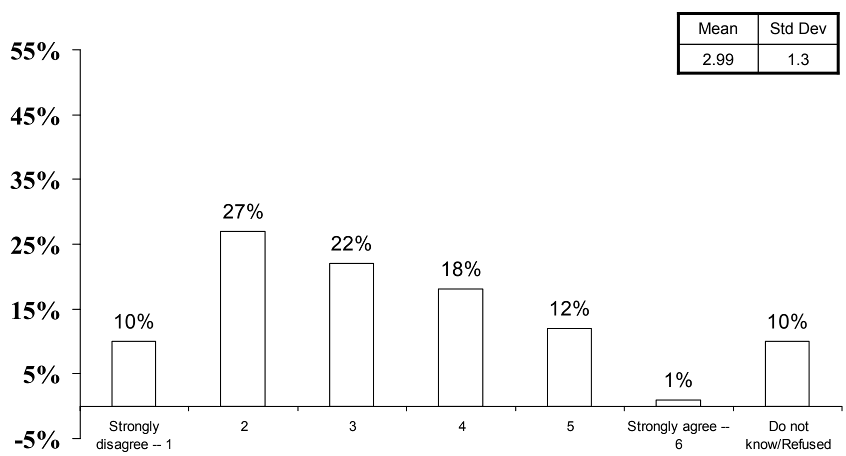
Q15.2 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

*The World Bank policy matrix also includes actions that are **complementary** to those necessary for achieving the program's outcomes*



Q15.3 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

*Some of the key policy actions necessary to achieve the program's outcomes are **not included** in the policy matrix negotiated with the World Bank*



Q15.4 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

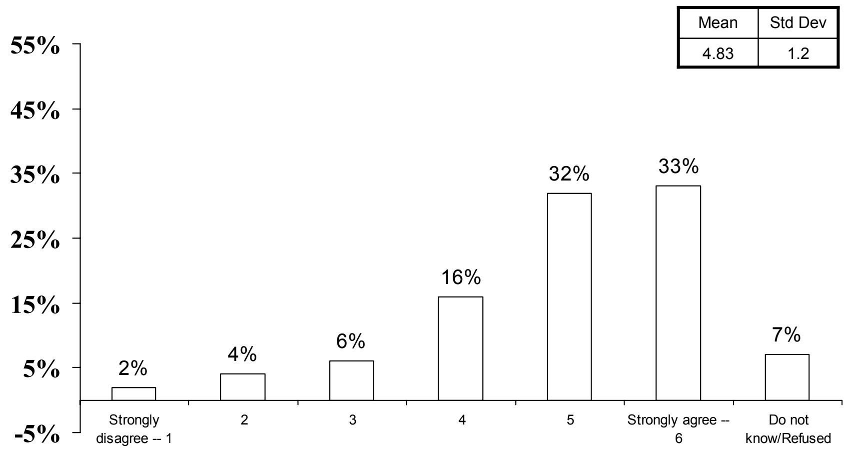
Rating Summary: Criticality of the Policy Actions Chosen As Conditions of the World Bank Support

Q15. Criticality of plicy actions as conditions of WB support	Mean	Std Deviation	Valid N
15.1 The World Bank policy matrix includes only those policy actions that are critical to the program's outcomes.	3.36	1.3	N=85
15.2 The World Bank policy matrix includes all actions that are necessary to achieve the program's outcomes.	3.93	1.2	N=85
15.3 The WB policy matrix also includes actions that are complementary to those necessary for achieving the program's outcomes.	4.14	1.0	N=85
15.4 Some key policy actions necessary to achieve the program's outcomes are not included in the policy matrix negotiated with the WB.	2.99	1.3	N=81

Source: May 2005 World Bank Conditionality Survey

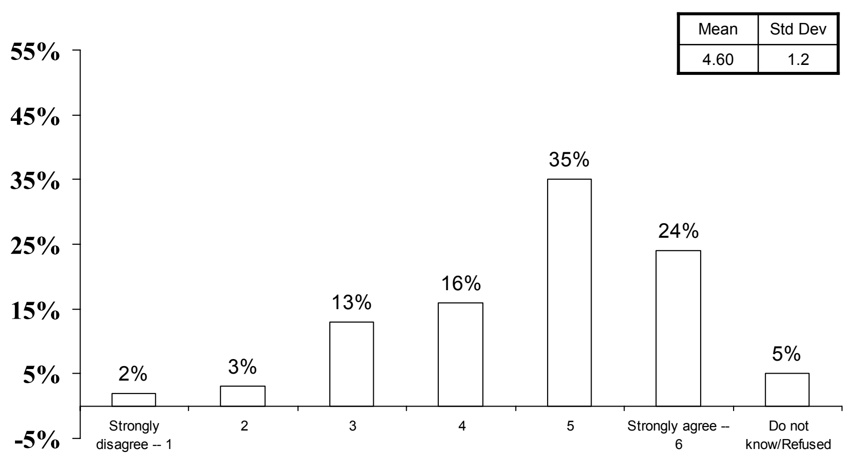
PREDICTABILITY OF WORLD BANK SUPPORT

The policy actions described in the policy matrix can affect the amount and timing of World Bank's financial support



Q16.1 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

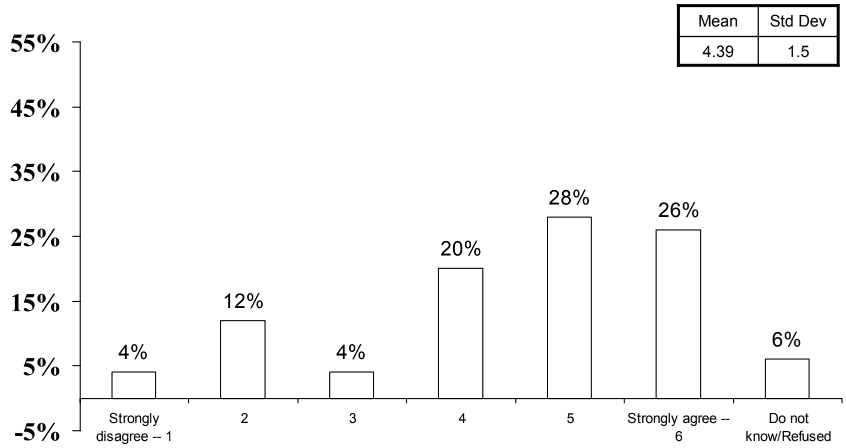
To receive World Bank's financial support, my government needs to meet all policy actions described in the policy matrix



Q16.2 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

To receive World Bank's financial support, my government needs to meet selected actions in the policy matrix, which are agreed by my Government and the World Bank to be critical for the program

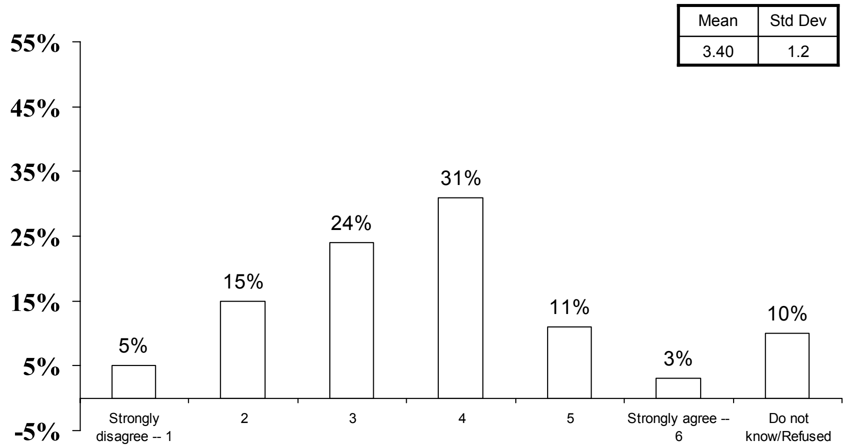
Mean	Std Dev
4.39	1.5



Q16.3 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

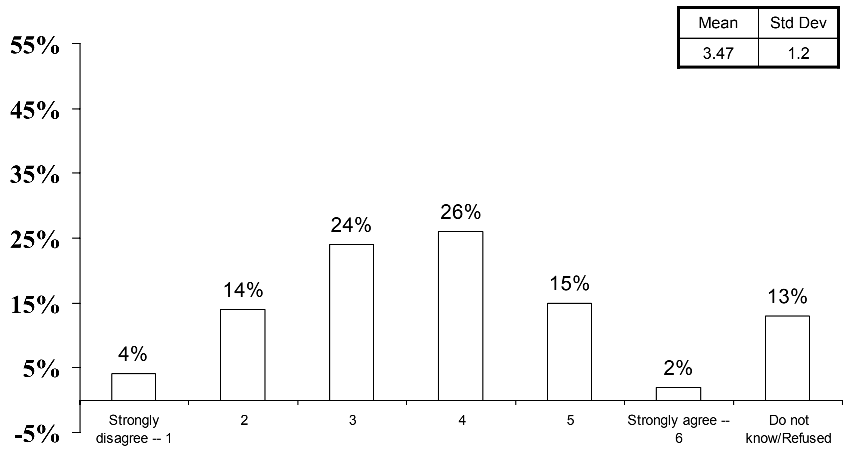
World Bank is flexible in granting waivers on its conditions for multiple-tranche policy-based operations, which allows my government to plan for the schedule and amount of next disbursements

Mean	Std Dev
3.40	1.2



Q16.4 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

World Bank is flexible in using triggers (expected prior actions) in the programmatic operations, which allows my government to move to the next prog



Q16.5 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

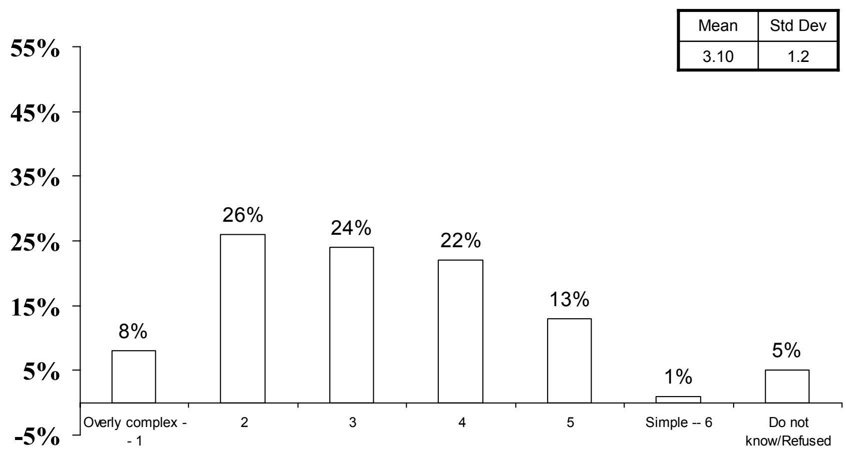
Rating Summary: Predictability of World Bank Support

Q16 Predictability	Mean	Std Deviation	Valid N
16.1 The policy actions described in the policy matrix can affect the amount and timing of World Bank's financial support.	4.83	1.2	N=84
16.2 To receive World Bank's financial support, my government needs to meet all policy actions described in the policy matrix.	4.60	1.2	N=86
16.3 To receive WB fin. support, my gov't needs to meet pol. matrix actions agreed by my Gov't and the WB to be crit. for the program.	4.39	1.5	N=85
16.4 WB is flex. in granting waivers on its condit. for multi-tranche pol.-based ops so my gov't can plan sched. & amount of disburse.	3.40	1.2	N=82
16.5 WB is flex. in using triggers in the programmatic operations, which allows my government to move to the next program.	3.47	1.2	N=79

Source: May 2005 World Bank Conditionality Survey

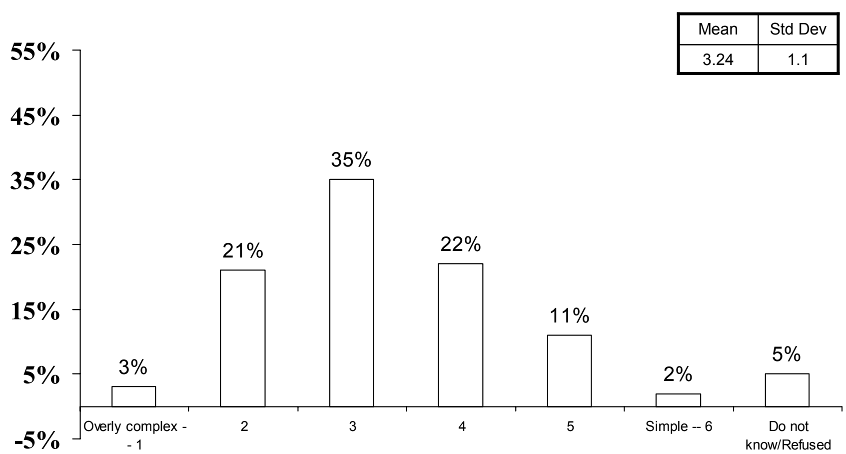
NEGOTIATING AND IMPLEMENTING THE WORLD BANK POLICY-BASED OPERATIONS

Designing World Bank policy-based operations



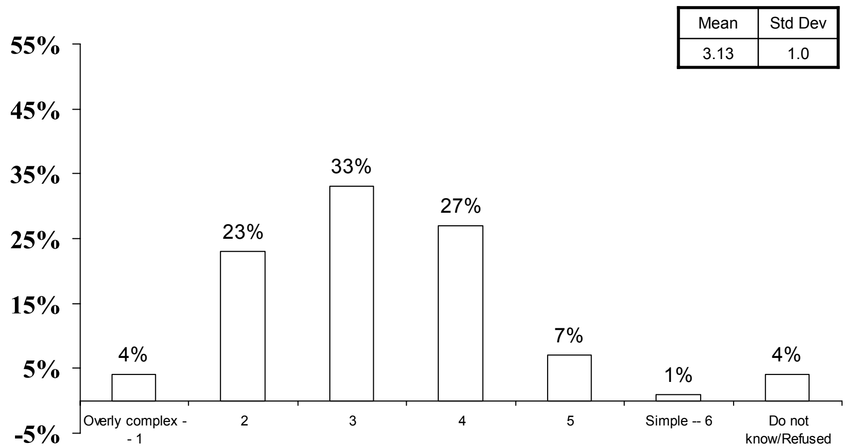
Q17.1 On a six-point scale where "6" means simple and "1" means overly complex, how would you rate doing business with the World Bank with respect to:
Source: May 2005 World Bank Conditionality Survey

Negotiating World Bank policy-based operations



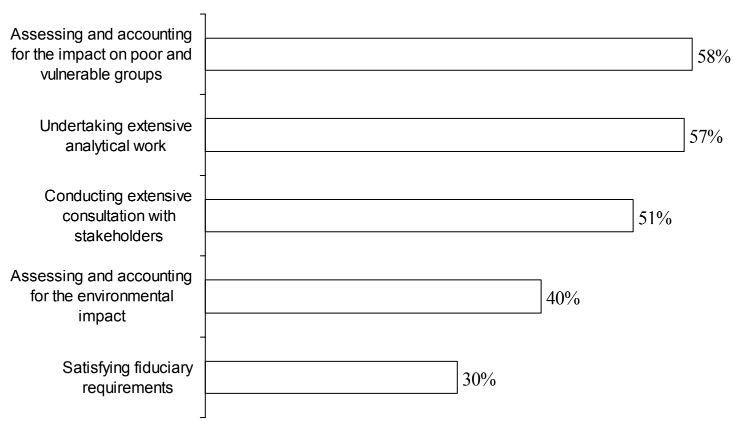
Q17.2 On a six-point scale where "6" means simple and "1" means overly complex, how would you rate doing business with the World Bank with respect to:
Source: May 2005 World Bank Conditionality Survey

Implementing World Bank policy-based operations



Q17.3 On a six-point scale where "6" means simple and "1" means overly complex, how would you rate doing business with the World Bank with respect to:
Source: May 2005 World Bank Conditionality Survey

Significant Challenges to Government Relation to World Bank Operations



Q18. In your view, which of the following constitute significant challenges for your Government in relation to World Bank operations? (Select all that apply)
Source: May 2005 World Bank Conditionality Survey

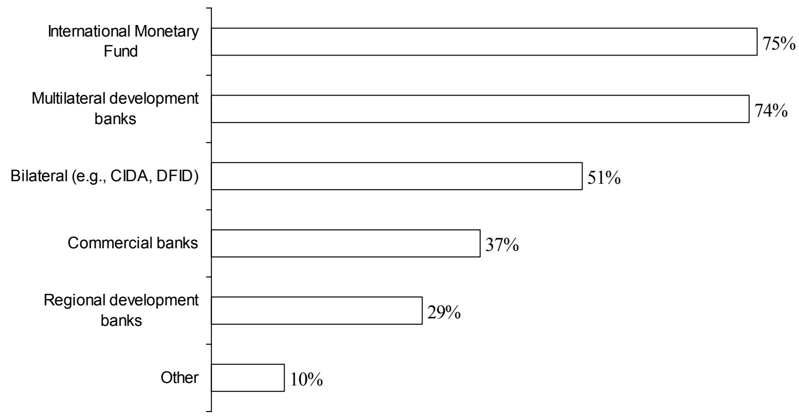
Rating Summary: Negotiating and Implementing the World Bank Policy-based Operations

Q17 Negotiating and implementing	Mean	Std Deviation	Valid N
17.1 Designing World Bank policy-based operations	3.10	1.2	N=86
17.2 Negotiating World Bank policy-based operations	3.24	1.1	N=86
17.3 Implementing World Bank policy-based operations	3.13	1.0	N=87

Source: May 2005 World Bank Conditionality Survey

HARMONIZATION AND ALIGNMENT AMONG EXTERNAL DEVELOPMENT PARTNERS

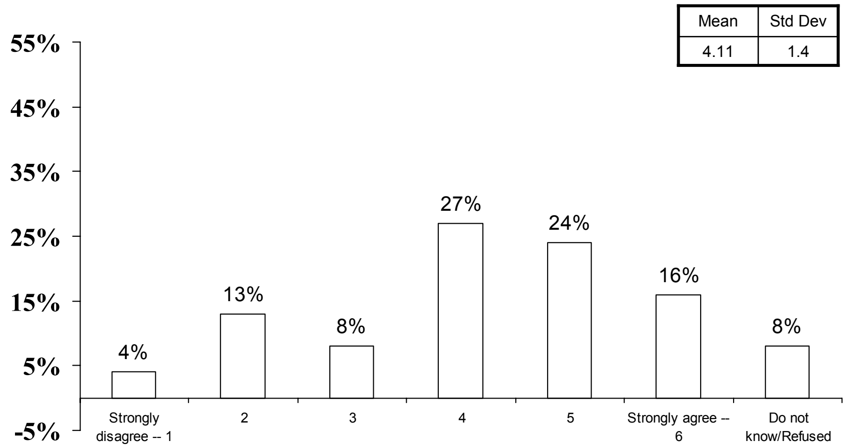
Policy-based Operations Organizations Dealt With As a Government Official



Q19. As a government official, have you dealt with policy-based operations of the following organizations? (Please select all that apply)
Source: May 2005 World Bank Conditionality Survey

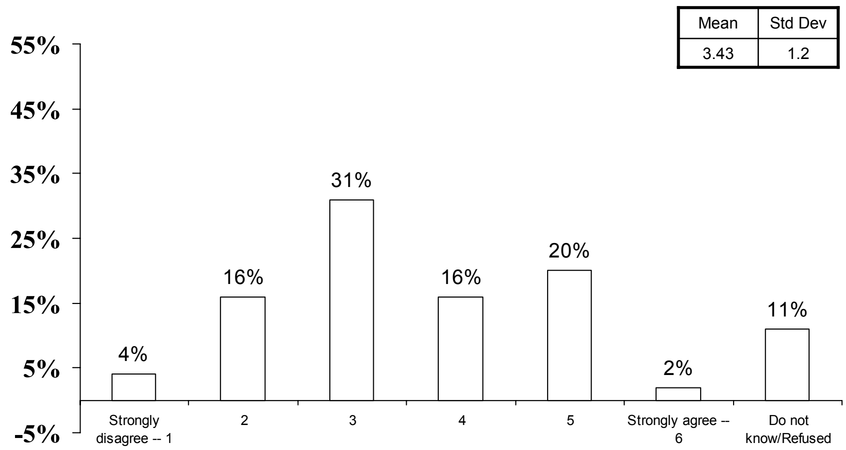
Harmonization and alignment have reduced the transaction costs (number of visiting missions, time spent, etc.) of negotiating with donors

Mean	Std Dev
4.11	1.4



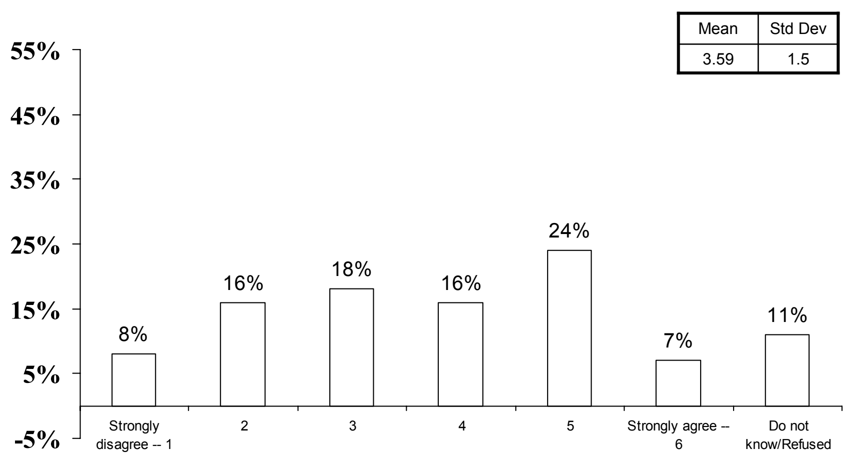
Q20.1 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Harmonization and alignment have significantly increased the number of policy actions my Government must deliver to obtain World Bank support



Q20.2 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

Harmonization and alignment have reduced the reporting requirements for receiving World Bank disbursements



Q20.3 On a six-point scale where "6" means you strongly agree and "1" means you strongly disagree, please rate your level of agreement with each of the following statements
Source: May 2005 World Bank Conditionality Survey

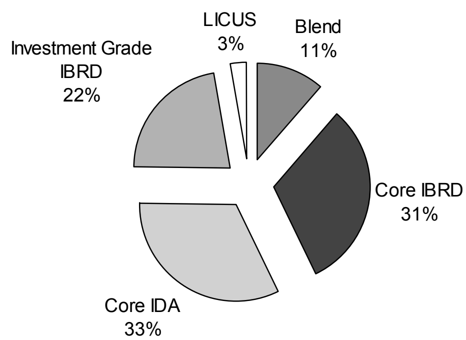
Rating Summary: Harmonization and Alignment Among External Development Partners

Q20. Harmonization and alignment	Mean	Std Deviation	Valid N
20.1 Harmonization and alignment have reduced the transaction costs of negotiating with donors.	4.11	1.4	N=85
20.2 Harmonization and alignment have significantly increased the number of policy actions my Gov't must deliver to obtain WB support.	3.43	1.2	N=80
20.3 Harmonization and alignment have reduced the reporting requirements for receiving World Bank disbursements.	3.59	1.5	N=82

Source: May 2005 World Bank Conditionality Survey

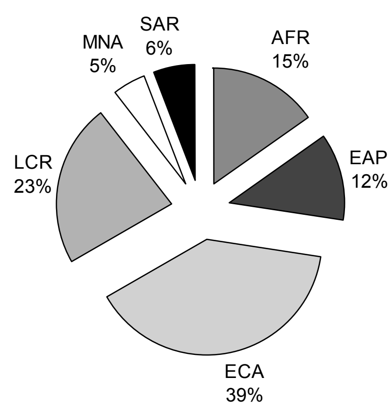
APPENDIX – SURVEY RESPONDENT DEMOGRAPHICS

Sample Demographics: Country Category



Source: May 2005 World Bank Conditionality Survey

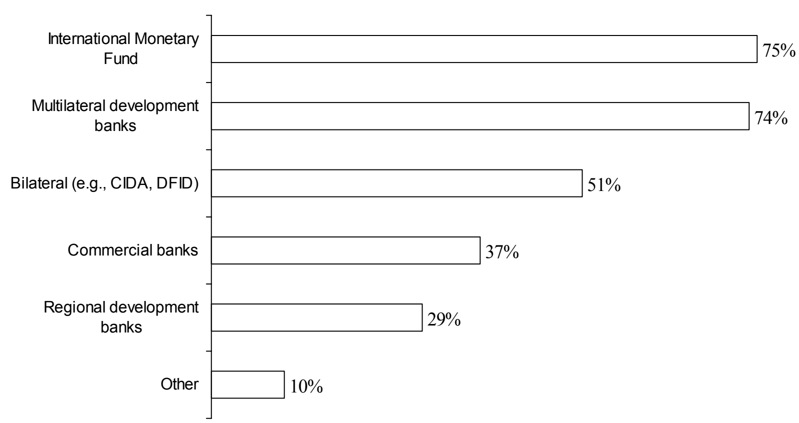
Sample Demographics: Region



Source: May 2005 World Bank Conditionality Survey

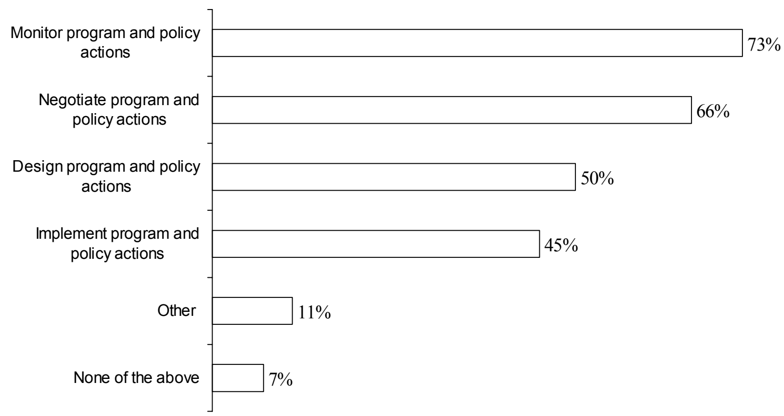
Survey Sample Statistics		Survey count	Survey composition	Sample count	Response rate
CountryCategory	Blend	12	11%	32	38%
	Core IBRD	33	31%	76	43%
	Core IDA	34	32%	86	40%
	Investment Grade IBRD	23	22%	44	52%
	LICUS	3	3%	23	13%
Region	AFR	16	15%	53	30%
	EAP	13	12%	43	30%
	ECA	41	39%	91	45%
	LCR	24	23%	51	47%
	MNA	5	5%	10	50%
	SAR	6	6%	13	46%
Overall Rating	High	33	31%	69	48%
	Good	69	66%	174	40%
	Poor	2	2%	14	14%
	Not rated	1	1%	4	25%
Economic Management	High	54	51%	115	47%
	Good	48	46%	127	38%
	Poor	2	2%	15	13%
	Not rated	1	1%	4	25%
StructuralPolicies	High	32	30%	62	52%
	Good	72	69%	190	38%
	Not rated	1	1%	4	25%
	Poor	0	0%	5	0%
Policies For Social Inclusion Equity	High	45	43%	92	49%
	Good	57	54%	151	38%
	Not rated	1	1%	4	25%
	Poor	2	2%	14	14%
Public Sector Management Institutions	High	22	21%	41	54%
	Good	73	70%	182	40%
	Not rated	1	1%	4	25%
	Poor	9	9%	34	26%
World Bank Board Member	Non Board member	74	70%	182	41%
	Board member	31	30%	78	40%
Table Total		**105**		**261**	**40%**

Policy-based Operations Organizations Dealt With As a Government Official



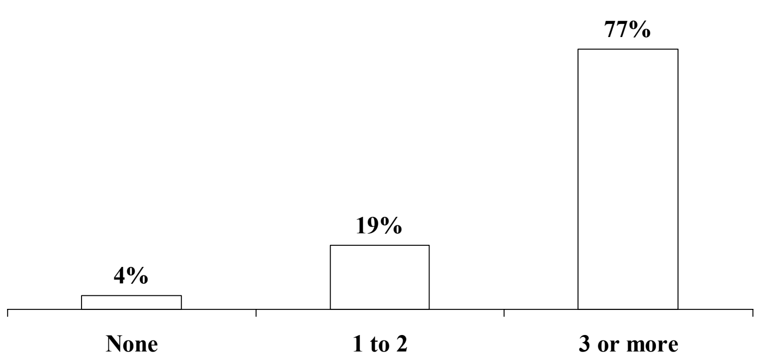
Q19. As a government official, have you dealt with policy-based operations of the following organizations? (Please select all that apply)
Source: May 2005 World Bank Conditionality Survey

World Bank Policy-Based Operations Role



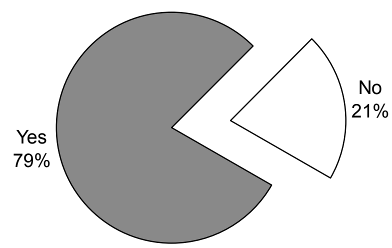
Q1 Please indicate your primary role in dealing with the World Bank policy-based operations. (Please select all that apply)
Source: May 2005 World Bank Conditionality Survey

Number of World Bank Policy-based Operations As a Government Official



Q2 How many World Bank policy-based operations have you dealt with as a government official?
Source: May 2005 World Bank Conditionality Survey

Incidence of Working With World Bank Programmatic Policy-based Operations



Q3. As a government official, have you dealt with World Bank programmatic policy-based operations?
Source: May 2005 World Bank Conditionality Survey

REVIEW OF WORLD BANK CONDITIONALITY
BACKGROUND PAPER 7

SUMMARY OF EXTERNAL CONSULTATIONS

OPERATIONS POLICY AND COUNTRY SERVICES
WORLD BANK

ABBREVIATIONS AND ACRONYMS

APL	Adaptable program loan
APR	Annual Progress Report
BMZ	German Federal Ministry for Economic Cooperation and Development
CAS	Country Assistance Strategy
CIDSE	International Cooperation for Socio-economic Development
CPIA	Country Policy and Institutional Assessment
CSO	Civil society organization
DAC	Development Assistance Committee (of the OECD)
DFID	Department for International Development
DPL	Development policy lending
DPO	Development policy operations
EC	European Commission
EURODAD	European Network on Debt and Development
EU	European Union
GDI	German Development Institute
IADB	Inter-American Development Bank
IDA	International Development Association
IFI	International financial institution
IMF	International Monetary Fund
ISN	Interim Strategy Note
JBIC	Japan Bank International Cooperation
LAC	Latin America and the Caribbean Region
LIC	Low-income country
LICUS	Low-income countries under stress
MDB	Multilateral Development Bank
MDG	Millennium Development Goal
MIC	Middle-income country
MTEF	Medium Term Expenditure Framework
NEPAD	New Partnership for Africa's Development
NGO	Nongovernmental organization
ODI	Overseas Development Institute
OECD	Organisation for Economic Co-operation and Development
OED	Operations Evaluations Department
OXFAM	Oxford Committee for Famine Relief
PAF	Performance assessment framework
PFM	Public financial management
PnoWB	Parliamentary Network on the World Bank
PRSC	Poverty reduction support credit
PRS	Poverty reduction strategy
PRSP	Poverty Reduction Strategy Paper
PSIA	Poverty and social impact analysis
SME	Small and medium enterprise
SPA	Strategic Partnership with Africa
SWAP	Sectorwide Approach
UN	United Nations
UNDP	United Nations Development Programme

SUMMARY OF EXTERNAL CONSULTATIONS

CONTENTS

ACKNOWLEDGMENTS

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SUMMARY OF EXTERNAL CONSULTATIONS

EXECUTIVE SUMMARY

1. In the course of the review of World Bank conditionality, staff engaged in an extensive process of consultation outside the Bank, with representatives of developing and donor country governments, civil society, and other multilateral institutions. This background paper reports on these consultations. It summarizes the main themes and key issues that emerged in the course of the consultations; provides details of the discussions at the seven conferences or workshops in which the Bank participated during the review; and summarizes a number of written comments and submissions received during the review. It reflects the strong focus in the consultations on conditionality applied to World Bank operations in low-income countries, the main subject of all the written comments and the main focus of discussion at six of the seven consultation meetings.

2. A number of themes recurred throughout the consultations, and have been influential in shaping the review's conclusions.

- ***Tension between ownership and conditionality.*** A strong degree of country ownership is widely seen as key to successful policy implementation, with broad acceptance that old style imposed conditionality tended to undermine rather than strengthen ownership. So where the Bank or other donors set conditions for the disbursement of their policy-based funds, these should draw from and be based on a country's strategy, as set out, for example, in a country poverty reduction strategy. Most developing country governments see themselves as in charge or in a process of taking charge of their development strategies, and in general welcome access to the global development knowledge of the Bank and other development partners through a process of dialogue. But others—particularly representatives of civil society—are concerned that this dialogue itself, given the power imbalance, can become controlling and intrusive, undermining ownership. Attempts to "buy" reforms by tying support to policy changes to be made in the future are generally seen to have failed, at least in the context of medium- and longer-term reforms.

- ***Types of conditions and indicators.*** There is a range of views about types of conditions or indicators to stress in choosing which country programs to support. Many donors and representatives of civil society put more stress on political aspects than on indicators of progress in economic and public financial management reform, although most accept that the Bank's mandate requires it to focus on the latter. Many also favor putting emphasis more on "process" conditions or indicators of institutional change. There is a lively debate about the potential role for "outcome"-based conditions. There is some understanding of the increasing use made in the Bank of a series of programmatic operations, with judgments made on the overall progress of a country's efforts towards medium-term program results, rather than the traditional compliance with specific ex ante conditions. At the same time, there are questions about the degree of discretion and consistency in making judgments and on the part of some middle-income countries concern about a potential loss of clarity on what is expected, with adverse consequences for the predictability of support. Many low-income countries see the increasing shift of many donors to budget support as welcome, but are concerned that some donors add to transaction costs by continuing to use separate reporting requirements and separate criteria for assessing progress.

- ***Scope of overall conditionality.*** Almost all of those consulted stress that conditions and benchmarks with the World Bank need to be seen in the wider context of the country's own development program and conditions and benchmarks set for its support by other development partners. It is recognized that, particularly where capacity is weak, countries need to focus attention on a few actions that are critical to success—and that those providing support, including the Bank, should do likewise, with calls for the Bank to play a leadership role in this regard. There are concerns that while the Bank has made some progress in reducing the burden of conditions in its policy-based operations, there may have been a reverse trend in conditions attached to investment lending operations.

- ***Predictability.*** Predictability emerged from the consultations as a key consideration, particularly in aid-dependent low-income countries, and there is currently much effort being made in the donor community to strengthen the predictability of support, both in the short and medium term. Good progress is being made in many cases in improving in-year predictability, with donors agreeing to disburse budget support early in a country's fiscal year. But many low-income countries see the need for further efforts in this respect, as well as further efforts to improve the medium-term predictability of flows.

- ***Accountability, monitoring, and public financial management.*** Consistent with and central to stronger country ownership, all parties stress the importance of stronger domestic arrangements for financial management, accountability, and monitoring, often with a key role to be played by national parliaments. The aim should be to use stronger forms of domestic accountability as the basis also for accountability to development partners. It requires greater transparency of government intentions and systems for monitoring progress and results. In many countries it also requires greatly strengthened systems of public financial management. Donors providing finance in the form of direct budget support see this as important for reducing their own fiduciary risk and helping to meet their domestic accountability requirements. They, and recipient country partners, also see a major payoff from budget support in increasing coherence and integrity of countries' budget processes and strengthening central control of budget priorities and execution.

- ***Role of conditionality in fragile states.*** While there is general agreement that the role for policy-based support in fragile states is limited, there is also recognition that in some cases it can play a critical role.

- ***Harmonization and alignment.*** A recurrent theme among all parties is the need to find ways to encourage development partners, including the Bank, to make further progress in implementing the commitments they have made to better align aid with country priorities and to harmonize practices and reduce transactions costs. Most believe that progress in this respect will require strong leadership by recipient governments.

- ***Nomenclature.*** There is also a widely shared view that the term "conditionality" may no longer correctly describe the emerging development process of budget support, with the stress on country ownership, and the use by the Bank of actions already taken to judge appropriate levels of support rather than setting conditions for the future against which support will be disbursed. There were a number of suggestions for a more appropriate nomenclature.

SUMMARY OF EXTERNAL CONSULTATIONS

I. INTRODUCTION

1. The review is being undertaken by the Bank in response to the Development Committee's request in its October 2004 meeting. [1] As stated in the communiqué, the Committee asked the Bank to "review its own policy and practice on conditionality" and "report on the continued efforts by the Bank and the Fund to streamline their aggregate conditionality" by the Fall 2005 meeting.[2] The objective of the review is to document the evolution of the Bank's approach to conditionality, take stock of the lessons of experience, and take a fresh look at the Bank's own practice of conditionality.

2. In the course of the review staff engaged in an extensive process of consultation outside the Bank, with representatives of developing and donor country governments, civil society, and other multilateral institutions. This background paper reports on these consultations. Section II summarizes the main themes and key issues that emerged in the course of the consultations. Section III gives more detail of the discussions at the seven conferences or workshops in which the Bank participated during the review. The account of the June 1-2, 2005 consultation meetings with middle-income countries is based on a summary prepared by the chairman and agreed with participants. Lists of participants in each event are included in Annex A. In addition, written comments and submissions were invited, and a website maintained for the purpose: the main responses received are summarized in Section IV. Written comments and discussion at six of the seven consultation meetings focused mainly on conditionality applied to World Bank operations in low-income countries, and this relative focus on low-income country issues is reflected in this summary.

II. KEY ISSUES

3. A number of themes recurred throughout the consultations, and have been influential in shaping the review's conclusions.

A. Tension between Ownership and Conditionality

4. There is broad agreement by all parties that a strong degree of country ownership is key to successful policy implementation, and that old style imposed conditionality tended to undermine rather than strengthen ownership. Ownership is not a simple concept, but is generally accepted to imply significant leadership by a country of its development strategy.

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1 As part of the Review, the following good practice notes have also been issued: *Results in Development Policy Lending* (SecM2005-0365), *Budget Support Groups and Joint Financing Arrangements* (SecM2005-0361), and *Fragile States* (SecM2005-0353).

2 See paragraph 7 of the Development Committee Communiqué, Joint Ministerial Committee of the Boards of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries, October 2, 2004.

- Where the Bank or other donors set conditions for the disbursement of their policy-based funds, these should draw from and be based on a country's strategy, as set out for example in a country poverty reduction strategy (PRS). Performance assessment frameworks (PAFs) agreed with the Bank and other donors should also ideally be based on a country's own policy intentions as set out in public strategy documents, for example as presented by the government to national parliaments.

- Most developing country governments see themselves as in charge or in a process of taking charge of their development strategies. For example, many low-income countries feel that second-generation PRSs are increasingly being developed without external support and better reflect national priorities than the initial PRSs. As a result of institutional constraints, first-generation PRSs often lacked operational details, were not clearly prioritized, or were subject to budget constraints—and in some cases were not developed with adequate time for broad consultations, with too much input from the Bank and other development partners, and sometimes prepared in parallel with already existing national planning documents.

- While representatives of developing country governments in general welcome access to the global development knowledge of the Bank and other development partners through a process of dialogue, others—particularly representatives of civil society—are concerned that this dialogue itself, given the power imbalance, can become controlling and intrusive, undermining ownership.

- Attempts to "buy" reforms by tying support to policy changes to be made in future are generally seen to have failed, at least in the context of medium-and longer-term reforms, so the Bank's emphasis on tying support to reforms already implemented is generally welcome.

B. Types of Conditions and Indicators

5. There is a range of views about which conditions or indicators to stress in choosing which country programs to support.

- Many donors and representatives of civil society put more stress on political aspects—including, for example, country records on human rights and respect for UN conventions—than on indicators of progress in economic and public financial management reform, although most accept that the Bank's mandate requires it to focus on the latter.

- Many also favor putting the emphasis more on "process" conditions or indicators of institutional changes than on individual "policy" changes, noting for example the overriding importance of establishing sound systems of public financial management and accountability from the point of view both of countries themselves and donors, who need to account to their parliaments for use of their funds.

- There is a lively debate about the potential role for “outcome”-based conditions, with broad acceptance of the importance of retaining focus on the ultimate results of programs supported—for example, in terms of educational attainment or reduction in disease—and installing the required systems of monitoring and evaluation, but doubts about the utility of mechanistic outcome indicators to guide year-by-year disbursement decisions.

- There is also a widely shared recognition of the role that trust between donors and recipient government plays in decisions on support. In this context there is some understanding of the increasing use made in the Bank of a series of programmatic operations, with judgments made on the overall progress of a country’s efforts toward medium-term program results, rather than the traditional compliance with specific ex ante conditions. At the same time, there are questions about the degree of discretion and consistency in making judgments on the basis of indicative triggers and, on the part of some middle-income countries, there is concern about a potential loss of clarity on what is expected for subsequent operations.

- Many low-income countries have experienced the increasing shift of many donors to budget support as a welcome aid modality, but are concerned that some donors are continuing to add to transaction costs by using separate reporting requirements and separate criteria for assessing progress.

C. Scope of Overall Conditionality

6. Almost all of those consulted stress that the use of policy matrices (including conditions and benchmarks) agreed between the recipient country and the World Bank needs to be seen in the wider context of the country’s broader development program and conditions and benchmarks set for support by other donors, including the IMF, other multilateral development banks (MDBs), and bilateral donors. While a government’s agenda is typically broad, it is also recognized that, particularly where capacity is weak, countries need to focus attention on the few actions that are critical to success—and that those providing support, including the Bank, should do likewise.

- The number of conditions or benchmarks itself, however, is a poor indicator of the overall difficulty of conditionality. Some conditions or benchmarks are much broader than others, requiring stronger efforts if they are to be met. Indeed, where the substance of a donor-supported policy program captures and supports the government’s own policy intentions—as most believe that it should—then in that sense there is no extra “burden” of conditionality at all.

- While some see advantage in separate conditions being set by different parties, as a way to reduce the aggregate variability of aid flows when some benchmarks are not met, most stress the need to align and streamline the totality of conditions set by all. In this context, country-level multi-donor budget support groups can play a useful role. There is general support not only for greater focus in the conditions included in Bank- (and Fund-) supported programs, applying the test of criticality, but also for the Bank playing a leadership role in this regard among other development partners.

- Many expressed a concern that while the Bank has made some progress in reducing the number of conditions in its policy-based operations, there may have been a reverse trend in conditions attached to investment lending operations.

D. Predictability

7. Predictability emerged from the consultations as a key consideration, particularly in aid-dependent low-income countries, and there is currently much effort being made in the donor community to strengthen the predictability of support, both in the short and medium term. Low-income countries with high levels of aid and their partners recognize this as a key issue—and expect the Bank to play its part. The shift to budget support, while welcome, leaves such countries vulnerable to unexpected changes in resource flows. Good progress is being made in many cases in improving in-year predictability, with donors agreeing to disburse budget support early in a country's fiscal year. But many low-income countries see the need for further efforts in this respect, as well as further efforts to improve the medium-term predictability of budget support flows.

- It is recognized that Bank programmatic support, for example through a series of poverty reduction support credits (PRSCs), gives some assurance of continuing flows, while also providing for accountability and performance checks at regular intervals. However, some countries are concerned about the political and administrative costs of needing to seek new parliamentary/congressional approval each year for a new loan within a programmatic relationship.

- It is generally accepted that the flow of regular budget support to low-income countries can only be fully predictable if the recipient country's performance remains adequate. While donors and countries alike recognize that uneven and disappointing country performance would lead to a reduction in aid, there is some concern that there must be a graduated response to avoid a disruptive curtailment on resource flows. Donors are gaining experience with different approaches, with some bilateral donors finding ways to make firm multi-year commitments for at least a portion of their support. Some question whether the Bank could not do more to assure countries that its programmatic support gives an equivalent degree of medium-term certainty.

- Middle-income countries, where external support typically accounts for a much smaller proportion of budget spending, are more concerned about a different aspect of predictability: they would like clarity about conditions to be met in multitranche operations and expected prior actions in programmatic operations, to provide certainty that Bank loans will be disbursed if the relevant actions are taken.

E. Accountability, Monitoring, and Public Financial Management

8. Consistent with and central to stronger country ownership, all parties stress the importance of stronger domestic arrangements for financial management, accountability, and monitoring, often with a key role to be played by national parliaments. The aim should be to use stronger forms of domestic accountability as the basis for accountability to development partners. Many suggest that alongside public financial management, stronger forms of domestic accountability should constitute an important form of "process" conditionality in some countries. There are several components.

- Domestic accountability requires greater transparency of government intentions and systems for monitoring progress and results.

- It usually implies a more active role for parliaments and local government, with full participation by civil society, in setting national strategies, as well as monitoring progress and holding governments accountable for results.

- In many countries it also requires greatly strengthened systems of public financial management. Donors providing increasing finance in the form of direct budget support see this as important for reducing their own fiduciary risk and in providing a way to meet their own domestic accountability needs without recourse to separate reporting and accounting requirements. They, and recipient country partners, also see a major payoff from budget support, as opposed to support for individual projects or sectors, in increasing coherence and integrity of countries' budget processes and strengthening central control of budget priorities and execution.

F. Role of Conditionality in Fragile States

9. While there is general agreement that the role for policy-based support in fragile states is limited, there is also recognition that in some cases it can play a critical role.

- The past approach of seeking to apply multiple conditions to compensate for weak policy environments is accepted by all to have failed.

- But in some cases, where there is judged to be strong commitment from the government, it is appropriate to take the risk of using policy-based support to build essential state functions, for example, of basic public financial management or payroll systems. In such cases, conditions should be highly focused and selective.

G. Harmonization and Alignment

10. A recurrent theme among all parties is the need to find ways to encourage development partners, including the Bank, to make further progress in implementing the

commitments they have made to better align aid with country priorities and to harmonize practices and reduce transactions costs. Most commentors, including those from recipient countries, believe that progress in this respect will require strong leadership by recipient governments. Most parties strongly welcome the example of countries that have taken a leadership role in coordinating donor alignment around common performance assessment frameworks and country assistance strategies, such as Mozambique and Tanzania.

H. Nomenclature

11. There is also a widely shared view that the term "conditionality" may no longer correctly describe the emerging development process of budget support, with the stress on country ownership, and the use by the Bank of actions already taken to judge appropriate levels of support rather than setting conditions for the future against which support will be disbursed. Suggestions for a more appropriate nomenclature include: "joint programming of policy and process improvements" or "mutual accountability framework," stressing the mutual accountabilities and responsibilities of countries and their development partners; or "government accountability framework," recognizing that governments are accountable in the first place to their own people and parliaments, with accountability to development partners, including the Bank, taking only second place.

III. Conferences and Workshops

A. London Workshop, December 13, 2004

12. The meeting, which marked the formal launch of the review, was organized by the United Kingdom's Department of International Development (DFID), with discussion opened by Secretary of State for Development Hilary Benn. Participants included representatives of DFID and the UK Treasury, as well as those from donor governments, civil society, and think tanks.

13. In opening the meeting, Secretary Benn said that conditionality is a key issue in donor relationships with developing countries, and noted that DFID was also reviewing the role of conditionality in UK aid and that he had encouraged the World Bank to undertake a review of its own approach and practice. He suggested that the review needed to address five sets of questions: the "scope and contents of conditionality"; the "appropriate level" on which conditions should applied—whether at country program level or on the level of specific interventions; donor harmonization and support for country-owned poverty reduction strategies (PRSs); the right kind of conditionality process for long-term aid and predictable aid commitments; and appropriate conditionality for fragile states.

14. After further opening contributions from the Bank, DFID, and others, in which the Bank described the background for the review, discussion centered on the tension between ownership and conditionality, aggregate conditionality, and accountability and the democratic process.

1. Tension between Country Ownership and Conditionality

15. Several participants from nongovernmental organizations (NGOs) raised the question of whether there should be policy-based conditionality at all, noting that its relationship with democratic decisionmaking needed to be examined. Some participants thought that conditions with a "results orientation" were more compatible with country ownership and with a long-term perspective. Others noted that technical assistance and economic and sector work could undermine country ownership and urged the Bank to look more at the asymmetry of donor-recipient relations and at political economy issues. A donor country participant also noted the imbalance between recipient countries and the international financial institutions—but drew a different conclusion, suggesting that increasing budget support may make donor involvement with country-based policy processes inevitable: "When we support budgets, we are responsible for the analysis and for the program."

2. Aggregate Conditions

16. Participants stressed the need to capture conditions from all international financial institutions (IFIs) and bilateral donors, with conditions tending to "migrate" between IFIs and other donors. They also noted the tension between aid recipients' need to receive aid in a predictable long-term way and donors' need for due diligence. Bank and IMF (which is carrying out a separate review) cooperation, particularly on governance, was questioned, with the IMF confirming that while it focused on macroeconomic management and the financial sector, when governance was a critical issue, it would take governance into consideration. Other participants pressed the need to look beyond the numbers of conditions to assess their weight and intrusiveness and whether "streamlining" had led to greater compliance or impact. There was broad agreement that conditionality in fragile states raised separate issues and should be considered at a separate meeting.

3. Accountability and Democratic Process

17. Many participants urged the Bank to look beyond governments, to the participation of parliaments and civil society, in poverty reduction strategies—a form of "process conditionality." NGO participants suggested an audit of how Bank processes are meshing with domestic political processes (e.g., if PRSCs are aligned with domestic budget cycles) and the need for independent monitoring. The Parliamentary Network on the World Bank (PnoWB) could play a useful role.

4. Concluding Comments

18. Concluding the discussion, a representative of the Bank noted that progress had already been made through closer alignment of World Bank and country processes and that as donor recipient partnerships develop and governments acquire "more space," the need for a good framework for assistance increases. He hoped that a conceptual framework and principles of good practice would emerge from the current review.

B. London Seminar on World Bank Conditionality in Fragile States, January 12, 2005

19. The seminar, cosponsored by the World Bank and Overseas Development Institute (ODI), focused on development policy operations (DPOs, defined to also include development policy grants) and program conditionality in fragile states. In addition to representatives from the Bank and ODI, participants included representatives from fragile states, regional development banks, bilateral aid agencies, the UN, and a number of NGOs. Discussion was based in part on a draft World Bank note—"Good Practice Note for Development Policy Lending: Development Policy Operations and Program Conditionality in Fragile States." Following introductory remarks from the Bank, a bilateral donor, and a former finance minister of a fragile state, discussion focused on the conditions in which development policy loans (DPLs) and budget support for fragile states might be appropriate; the required policy framework and its timeframe; the nature and number of specific conditions; and relationships among the Bank and other development partners.

1. Role of Conditionality in Fragile States

20. There was broad agreement that policy-based support for fragile states by the Bank (and also budget support from other donors) will only be appropriate in a limited number of circumstances—essentially cases when a country is in transition to a more ordered status, often in post-conflict situations. Participants from the Bank and some bilateral agencies stressed the important contribution that policy-based support could make to a fragile state in transition. The representative from a fragile state noted the crucial contribution that multilateral DPLs and bilateral budget support had made to development in his country—and its central contribution to building state functions and government financial capacity. Donor practices in relation to project support fragmented the budget and undermined the uniformity of public sector rules (for example, on environmental issues), and donor-supported technical assistance had proved very poor value (twinning arrangements with ministries in more successful developing countries would be a better approach). Participants from some bilateral donors believed the importance of budget and development policy support to be less central. While accepting that DPLs and budget support could play some role in assistance to at least some fragile states in transition, they stressed the great variation in country circumstances, the importance of focusing on institution building, and the unwillingness of their own agencies to take the fiduciary risk of providing budget support in such circumstances.

2. Addressing Risks

21. All participants accepted that there were considerable risks associated with policy-based support in fragile states, even in cases where it would be appropriate: fiduciary risks, security risks, risks from the political situation, and risks from weak institutions. And all agreed that it was important to assess these risks carefully and as far as possible address them in the program of policy reform being supported, recognizing that establishing strong institutions and a strong financial framework would take many years to achieve.

3. Nature of the Medium-Term Framework

22. Participants generally agreed that policy-based support should be provided on a predictable and medium-term basis, implying some form of medium-term policy framework and corresponding commitment from development partners. But they also recognized that while the reform agenda would be very broad, any medium-term policy framework had, initially at least, to be kept very simple (a full PRS would be much too elaborate) and complemented with focused short-term action plans anchored in the annual budget process. Many participants expressed a concern that a narrow focus on final "results"—for example in terms of poverty reduction—would not be helpful. Countries needed a regular review process that focused more on identifying policy actions to be taken in the short run, rather than on final results where progress could only be measured (and corrective action be taken if needed) in the longer run.

23. In discussing the desired content of short- and medium-term policy frameworks, some participants stressed the importance of securing improvements in processes: establishing a working budget process, a payroll system for public employees, a public spending and financial control system, and viable public institutions. Others focused more on desired policy changes, including the central importance of reforms likely to produce growth and employment. While actions in this area—for example, to remove obstacles to setting up businesses or to create property rights—took time to have an impact, experience in some countries suggested that they could be crucial to success. Others noted the difficulty of making a clear distinction between process and policy actions, and the variety of country circumstances, which meant that while there might be broad agreement on the content of reform programs over time, decisions about correct sequencing needed to be made on a country-by-country basis.

4. Selectivity

24. There was broad agreement that specific conditions for DPLs in fragile states should be highly selective, taking into account the constraints imposed by limited capacity. Experience had been that while the average number of conditions was greater than for other borrowers, applying multiple conditions in fragile states had not led to better outcomes. Some participants supported the view that the early focus should be on changes already achieved, together with an insistence on a good continuing policy dialogue. Most stressed the need to remain flexible, with a rather limited number of conditions that would allow the government to exercise its leadership—participants called for sharper, smarter, fewer, and sequenced conditions. There was support from many for the view that "conditionality" was an inappropriate name for what is now generally seen as "joint programming of policy and process improvements" between government and external partners. There was also a request for the Bank's review to be widened to consider conditionality on investment operations as well and conditionality imposed by other donors.

5. Cooperation among Development Partners

25. In general, participants did not distinguish between conditions on World Bank DPLs and conditions attached to budget support from other donors. They noted the need to keep the totality of all conditions set by all parties simple and the role that agreed policy action frameworks should play in this respect. One bilateral donor noted the value of multi-donor trust funds in minimizing overlapping conditionality and achieving harmonization. Participants from the Bank and UN acknowledged the special partnership between them in this group of countries, where typically the UN has been active for longer than the Bank.

6. Good Practice in Development Policy Operations in Fragile States

26. Finally, many participants welcomed the changes in Bank thinking and practice that have already taken place in recent years and stressed the importance of implementing these changes well and uniformly across countries of operation. In this context, they welcomed the Bank's draft note on good practice in development policy operations and program conditionality in fragile states, and looked forward to a completed version being disseminated and actively used to improve the quality of future operations.

C. Consultation with Civil Society Organizations, Paris, February 4, 2005

27. The meeting with civil society organizations (CSOs) was held at the World Bank office in Paris. Bank representatives explained that the conditionality review was one of several interrelated reviews taking place during 2005. A review of the PRSP process was also currently under way with the same timeline as the conditionality review. The PRSP review would focus on integration of PRSP processes with budget processes, approaches in fragile states, participation, and the use of the PRS as mutual accountability framework. The conditionality review would focus on past conditionality trends and implementation issues related to conditionality design, conditionality content, country ownership, predictability, harmonization, and fragile states.

28. Bank representatives began with a presentation of recent trends in World Bank conditionality, explaining the objectives of the 2005 review based on the World Bank's issues paper. The review would focus largely on conditionality for policy-based lending, considering issues of implementation and potential new guidelines that would reflect good practice principles for the design of development policy lending.

29. Presentations by participants focused on the following aspects.

- ***Scope of the review.*** Participants noted that conditionality also played an important role in certain investment operations, notably sectorwide approaches (SWAPs) and adaptable program loans (APLs), expressing concern that the relatively narrow focus on policy-based lending may miss important aspects. There may be examples where conditionality for development policy lending has been dropped only to reappear as a series of conditions for investment loans. In addition, participants noted that many borrowers/recipients of World Bank support see the list of "desired policy actions" as conditionality, not just the narrower set of legal conditions, making it desirable to look at both measures. Moreover, there was concern that the observed reduction in the number of conditions had simply reflected a move to more "general" conditions (i.e., satisfactory implementation of a strategy), each covering a range of actions. The review should stress the mutual accountability of borrowers/recipients and the World Bank and also examine the sustainability of interventions and issues of aid dependency.

- ***Ownership.*** Participants also hoped the review would address issues of ownership: was the Bank taking ownership principles seriously and truly basing its conditions on national processes? Although the decline in the number of conditions was useful, what was more important was the approach to reform choice and the process by which conditions were derived. Was the Bank setting conditions not included in a national strategy, and if so, why? In this context, the Bank should avoid formulaic approaches to reform, focusing more on the ultimate objective of poverty reduction. Linkages between conditionality and poverty social and impact analysis (PSIA) were important: PSIA should also stress national leadership and allow for different policy options.

- ***Nature of conditions.*** Some participants suggested that rather than focus on economic reforms, conditionality should reflect human rights aspects and issues of gender discrimination. Others noted the role of the diaspora, small and medium enterprises, and decentralization in alleviating poverty

- ***Aggregate conditionality.*** Aggregate conditionality with the IMF was an important consideration to be addressed. Is the IMF "off-loading" structural conditionality to World Bank operations? In general, participants felt that harmonization of conditionality was important, while noting the danger of "ganging up" of donors that could undermine sovereignty.

- ***Fragile states.*** Participants asked for particular attention to be given to fragile/failed states. The practice of overloading them with conditions should be avoided. Selectivity of lending favors better performers and could be in conflict with helping the poorest in fragile states. Performance-based allocation through Country Policy and Institutional Assessment (CPIA) should not become "mega-conditionality," and it would be useful to review the role of CPIA in this regard.

- ***Evaluation.*** The review paper should examine how the Bank internally and the Operations Evaluations Department evaluate quality of policy-based lending and ways to better understand the improvements in quality over time.

- ***Participation.*** Participants suggested that parliaments and civil society should have a voice in deciding the content of conditionality. The capacity of civil society should be reinforced to allow effective participation in oversight of activities, especially budget spending. NGOs could contribute to program design and definition of indicators as well as to evaluation.

29. Subsequent discussion highlighted the general tensions that can exist between conditionality and ownership, and between country selectivity/performance and predictability of aid flows. Bank representatives explained that joint conditionality issues had already been studied jointly and will be presented in the IMF conditionality review papers (due in April 2005) and the Bank's own conditionality review. Participants also discussed the ways in which the results of the review could be used to enhance the implementation of Bank operations. A recurrent theme in this regard was the importance of in-depth study of policy impact, and the possibility of input from stakeholders into the choice of policies from a menu of options. CSO participants requested that the review strongly focus on the issue of ownership and implementation of policies. The review should reflect some of the practical tensions and difficulties in implementation as well as "off-loading" of conditions from development policy to investment lending, presenting select country cases (perhaps in boxes). Participants suggested that CSOs would be ready to provide input for this discussion, as well as background notes that could be presented to the Executive Board as a separate annex of the review paper.

D. International Policy Workshop on "The Role of Conditionality in Policy-Based Lending," Berlin, April 6-7, 2005

30. The workshop was convened by the Development Policy Forum of InWEnt—Capacity Building International, Germany—in cooperation with the German Development Institute (GDI) and the Federal Ministry for Economic Cooperation and Development (BMZ). Participants included senior representatives of the World Bank, IMF, bilateral donors, the European Commission (EC), the Development Assistance Committee of the Organization for Economic Co-operation and Development (OECD-DAC), officials from middle- and low-income developing and transition countries and a number of civil society organizations.

31. The workshop began with a welcome from the conveners and presentations from the World Bank and IMF on new approaches to policy-based lending, and successive sessions addressed issues of ownership, the use of results-based conditionality, process and consensus building for country reform agendas, harmonization and alignment, and emerging principles of good practice.

1. New Approaches to Conditionality

32. There was broad agreement that practice in the use of conditionality had changed greatly in recent years, probably to a point where the term "conditionality" was no longer appropriate. An important underlying factor was the shift from a focus on short-term reforms to support for medium- and long-term programs. There was a general recognition that providers of aid were entitled to decide whether or not to provide support and would set criteria for deciding; and that they needed adequate fiduciary accountability. But representatives of multilateral agencies and donors said they no longer believed that aid could be used to "buy reforms," although discussion of conditions with governments

could help trigger a process of reform that led to development results and progress toward achieving the Millennium Development Goals (MDGs). Most stressed that nowadays "conditions" for support related to past rather than future actions, and that "benchmarks" set for the future did not have the same nature as binding conditions and that failure to meet them should be treated flexibly and perhaps met with only a graduated response.

33. Developing country representatives stressed that their reform programs were their own. One said that in his country people no longer referred to conditions, but rather to "agreed actions." There was general agreement with the view that conditionality was evolving into a partnership with mutual accountability (with mutual obligations spelled out) between countries and development partners, while remembering that governments in the first place were accountable to their own populations. A CSO representative suggested that governments spent too much time negotiating with donors and the IFIs, leaving insufficient space for debate and dialogue with their home populations. Others emphasized the imbalance in power between development partners and low-income country governments, and the continued "conditionality" mindset in some cases, particularly where trust was low.

2. Ownership

34. There was a wide consensus that country ownership is essential for success. Developing country participants stressed the importance of strong country leadership. Development partners recognized, however, that the process of establishing good country-owned strategies and programs takes time, that governments need policy space and time to build necessary institutions and stronger public financial management, and that, in many cases, the process has some way to go. A participant suggested that ownership should be seen as an outcome to build on rather than a precondition for engagement by development partners. Transparency and accountability were important aspects of ownership—governments needed to be clear about their proposed actions, so that they can account to their people and parliaments. Donors also should be transparent and clear about their commitments.

3. Nature and Number of Conditions

35. There were mixed views on the attractiveness of the approach pioneered by the EC of focusing on outcome-based conditionality: there was general acceptance of the need to focus more on outcomes and results but concern that the consequent results chain was too long to use outcome indicators widely as a basis for conditionality. But there was broad support for another aspect of the EC approach—that given the importance of aid predictability, the response to failure to meet conditions or benchmarks should be graduated rather than abrupt. Others noted that conditions should recognize accumulated international knowledge of what works—such as fiscal discipline, unification of exchange rates, and programs such as Education for All—and what does not.

36. There was also strong support for greater focus by development partners on a few critical conditions. Many suggested the right approach was for countries to set out their policy and action plans in a policy framework, and for development partners then to

choose from that framework those few actions on which they wished to focus. Some stressed as an advantage of this approach that it would increase predictability, since if actions and benchmarks chosen by some partners were missed, those chosen by others would be achieved. Others noted that the approach tended to lead to a very large number of benchmarks, albeit with different ones being stressed by different partners. A CSO representative suggested replacing conditionality with a charter for "responsible lending," based on political dialogue, with recipient countries' respect for a wide range of UN conventions and standards—on human rights, environment, transparency—and a focus on pro-poor growth.

4. Creating National Consensus

37. Wider participation should be seen not as a challenge to legitimate government but as a way to build wider and more sustainable ownership and trust in public institutions in a country. The macroeconomic framework was too often excluded from effective public debate. A CSO representative suggested ownership should be defined as "ownership by a credible majority of the population, with the rights of the minority respected." Strong and effective engagement by parliaments was also important, an aspect of ownership that needed more attention in some cases. One participant suggested that parliamentarians should be free to vote on reform programs as a matter of conscience, and that programs should only be approved if they commanded a comfortable majority extending beyond the government coalition. Several participants suggested the need for much more attention to involving local government as well as civil society, for more education and political capacity building, and more involvement of local communities. More attention should be given to how to create ownership and build consensus in situations where the government was not providing effective leadership.

5. Harmonization and Alignment among Development Partners

38. The Paris declaration contained a set of important commitments on ownership, alignment, results, and mutual accountability. Implementing these agreements on the ground would take time. Most participants agreed that the process must be led by recipient countries, as was already happening in some cases. Independent reviews of progress in country assistance strategies, as had been carried out in Tanzania, could assist the process.

39. Many emphasized that all actions supported by partners should be based on the country's own policy action framework; that there should be strong focus on a shortlist of perhaps 10 actions at most, making joint negotiation of conditionality desirable; that decisions on donor support should match country budget decision cycles; and that donors should cooperate and specialize, and remain silent on other issues as a way to reduce transaction costs on recipients. While final outcomes and results should be monitored better and statistics improved, too much should not be expected too soon; and monitoring and reporting systems should not overburden country capacity. Donor efforts to strengthen country capacity should complement and build on, not substitute for, existing country capacity.

40. Developing country representatives and many development partners stressed the benefits of providing support through the budget, using country financial systems as a basis for harmonization and strengthening budget systems by ensuring that support was captured in the budget rather than flowing off-budget. Other donors noted difficulties in persuading national legislatures that money disbursed through country budgets would be used well—though all agreed on the importance of reporting project expenditure plans and outcomes, even when subject to separate accounting arrangements, so they can be included in government financial planning and accounting. There was broad agreement on the need to monitor ongoing experience with budget support and multi-donor budget support groups, and to examine issues that arise (such as the need to maintain balance between unified donor groups and government) and learn lessons from experience.

E. Consultation with Low-Income Countries, Washington, DC, April 22, 2005

41. The consultation, organized by the World Bank, was arranged with representatives of governments and parliaments of low-income country borrowers from IDA. Apart from brief presentations of issues for discussion, staff of the Bank and IMF attended as observers only. There were three sessions, addressing issues of medium-term framework and ownership; criticality of conditions, program additionality, and process conditions; and predictability of Bank support, donor harmonization, results framework, and monitoring and evaluation.

1. Medium-Term Framework and Ownership

42. Participants focused their comments on the processes for producing PRSs in their countries, and the extent of national ownership, reflecting a diversity of national experiences.

- Some participants noted that for political or other reasons their governments had wanted little or no Bank or Fund role in building national strategies—for which they had deliberately chosen names other than poverty reduction strategy, such as "medium-term development strategy" or "unlocking the potential." The results were country-owned strategies, approved by parliament and supported by IDA and other development partners—though in the case of a prospective EU member country, IDA's role was declining with the prospect of EU accession and growing EC support in that process. In one case, wide consultation with parliament, NGOs, and ordinary people had added much to the strategy.

- Other participants said their initial PRSps had been too much Bank documents (in one case, not much more than a "compilation of Bank projects") with too much social focus, and important gaps in areas like water supply, primary education, and housing. Second-generation PRSps being developed, often starting from consultations with municipalities and provinces and sector plans (including the private sector), were more satisfactory, identifying investment priorities for roads, power, and water, and were better integrated with national budgets and medium-term expenditure frameworks. In one case, there had originally been two documents—a draft PRS and a draft medium-term development plan—but the former was now being incorporated in the latter.

- Other participants stressed that their governments welcomed Bank and Fund participation in helping prepare their PRSs and welcomed the positive role being played by budget support groups of donors. In some cases, close Bank/Fund involvement was needed as donors wanted a positive signal from the Bank and Fund.

43. Participants from national parliaments stressed the important role parliaments should play in developing and approving national strategies and in following up implementation, holding governments truly accountable for budget decisions and outturns. Parliaments, however, needed support with capacity building if they were to carry out this function effectively.

2. Criticality, Additionality, and Process Conditions

44. Several countries represented had or were negotiating (and strongly welcomed) multi-donor budget support arrangements linked to policy action matrices of conditionality. Participants stressed the importance of linking such matrices to PRSs, with several suggesting that the process of annual PRS review had become redundant: annual review of policy action matrices and budget implementation should be sufficient. They also noted problems of different IFIs and donors looking for different triggers, leading to multiple conditions, and the existence of actions seen as important by government (such as increasing access of poor people to the courts or technical education) but not emphasized by the Bank or donors. Some called for stronger Bank/Fund coordination and others noted the role of PRSCs as a vehicle for harmonizing conditionality among donors—commending the leadership role the Bank was taking in multi-donor budget support groups.

45. In general, participants saw conditionality as linked to PRSs, though often more specific. They also saw them as setting out actions governments themselves wished to take, rather than ones that were imposed. Several noted that producing PRSs was itself a form of process conditionality—but that the process, including wide consultation, had proved beneficial.

3. Predictability of Support, Harmonization, Results, and Monitoring and Evaluation

46. Several participants mentioned problems of unexpected external shocks that put programs off track: the Fund, Bank, and other donors should recognize that some indicators are not in the government's control. Others noted the need to have attainable targets and to avoid on/off triggers—support could be graduated according to performance.

47. Harmonization offers potential to greatly reduce costs for recipient countries but had not done so yet. Donors should implement the agreements made in Paris. Some

participants noted the need for recipient countries to monitor donor behavior and hold donors to account.

48. Several participants noted that results-based monitoring and evaluation systems were in the process of being set up—and required resources and support from the Bank and other donors. Indicators had to be trackable and transparent and should be chosen with care. One participant stressed the potential role of parliaments in monitoring results and how financing is being used and called for the Bank to work with parliaments to strengthen capacity in this regard.

F. Practitioners' Forum on Budget Support, Cape Town, South Africa, May 5-6, 2005

49. The forum, organized by the World Bank, brought together a wide group of representatives of donors, recipient governments, international institutions, and researchers with experience of budget support mechanisms (including related issues of aid coordination and conditionality).

50. The forum immediately followed two days' discussion in the Budget Support Working Group of the Strategic Partnership with Africa (SPA). Key issues and recommendations identified by that working group were presented to the forum and formed part of the discussion.

1. Recent Developments in Budget Support

51. World Bank participants outlined the context for growing use of budget support, and some of the key issues to be addressed:

- Growing use of budget support resulted from disillusion with both traditional aid projects and the traditional approach to conditionality for policy-based lending, recognizing the need to strengthen government ownership and systems, shift from supporting short-term to medium-term reforms, improve predictability of aid flows, exercise more selectivity between good and poor performers, and increase the focus on results. As an approach, it offers many benefits, including ease of scaling up assistance. But there are also concerns: fiduciary issues and weak public financial management (PFM) capacity, lack of the visibility for donor support that is provided by projects, potential volatility of support, and donor coordination costs.

- Among the outstanding issued to be addressed are the following: tensions between responding to differential performance and providing predictable support; finding ways to increase results orientation; shifting from a conditionality framework to a government accountability framework; improving PRS/PAF/ budget links to reconcile supporting a broad program with focusing on a few actions critical to success; and finding ways to reduce transaction costs while strengthening dialogue and donor coordination—both among donors, and between local donor offices and headquarters.

- Fiduciary issues discussed included the following. Donors, including the Bank, have to accept a degree of risk. Knowledge about country PFM systems has improved, but different donors have different risk thresholds. The Bank is prepared to provide budget support in certain cases where PFM is weak, so long as there is sufficient commitment to strengthen it. Stronger PFM is a key issue for development as well as for fiduciary risk.

52. A donor participant described progress to date with a joint multi-donor evaluation of budget support. A participant from a developing country stressed the important benefits of general budget support relative to sector or project support in helping finance ministries exercise necessary overall financial discipline—including ensuring coherence with the macroeconomic framework and avoiding issues of fiscal space and "Dutch disease." This was a recurrent theme throughout the forum, with both donors and recipient country representatives putting much stress on the benefits of general budget support in strengthening finance ministry control and PFM, and avoiding the adverse effects in this regard resulting from project and sector support provided to sector ministries. A donor participant noted that partly for this reason, as well as dissatisfaction with traditional project support, her agency is switching into budget support—with an aim of having 50 percent in that form in Sub-Saharan Africa by 2007. She saw a major goal as being to strengthen countries' PFM, and success in this regard would help in securing stronger backing in donor country parliaments for the budget-support approach. Along with other donors, she also stressed the need for effective assistance to help countries build PFM capacity.

3. Budget Support and Programmatic Alignment

53. Presentations by participants from ODI, World Bank, and Japan Bank for International Cooperation (JBIC) noted the following issues:

- Achieving better donor alignment with country programs depends above all on leadership from recipient governments, which in turn depends on country political systems.

- The need for more action-orientated PRS annual progress reports (APRs) linked to reformed and focused PAFs. The two together (other participants suggested the documents could be merged) should provide a basis for dialogue on a broader long-term agenda linked to final results, while also focusing on a few short-term critical actions to serve as benchmarks for support.

- Experience of budget support in South Asia, where the agenda is for second-generation reforms, also reflects the importance of politics, including electoral politics, in countries where politics is often clientelistic rather than programmatic—which presents challenges. Budget support in these countries has helped generate ownership and enhance PFM, while providing flexibility on the timing of disbursements when progress is less than expected. Decentralization to both the state and district levels presents a further challenge, although in some cases competition between states has been a positive factor.

- JBIC's experience in Vietnam suggested that successful budget support requires strong prior country efforts to improve PFM and policies, suggesting that the process might take some time in many African countries.

- A World Bank study of experience in five countries suggested that the PRS process (widely defined) has been associated with increased data availability, including better poverty analysis and a better results focus in medium-term expenditure frameworks; increased openness in and scrutiny of budgets, both within and outside governments, leading to stronger links with sector strategies; and better coordination within governments. At the same time, parliamentary influence, while still weak, has been growing—but will not necessarily be a force for stronger poverty focus. PRSs seem particularly weak on measures to improve revenue generation. Donors have made progress in integrating support into the budget process—but could do more to reduce strains on governments by improving predictability and aligning their timetables with national processes

54. Commenting, a recipient country finance ministry official emphasized the importance of donors understanding political context, and of the accountability of recipient governments first and foremost to their parliaments. He also stressed the need to strengthen capacity below the ministerial level, both to implement ministers' decisions and to handle the dialogue with partners. The EC representative stressed the benefits he saw from incorporating results-based triggers into budget support—not least as a way of strengthening donor country parliamentary support. Another participant noted the relevance of the NEPAD peer review process, and the need to remember other elements of the development agenda such as debt, trade, and regional integration.

3. Predictability of Budget Support and Aid Dependency

55. Presenters from the World Bank analyzed evidence of variability of budget aid and ways to make it more predictable. Recent evidence suggested that it is less variable over time than in the short run—but that while shortfalls reduce investment, excess disbursements do not increase it. Recipients could insure against short-run variability by building up and drawing on reserves. Donors could provide greater predictability at little cost by following the existing practice of some and making predictable disbursements on a core of support—reviewed perhaps every three years—with perhaps a 10 percent tranche subject to annual variation. In discussion, both ideas got support, though there were questions about rules for managing buffer reserves. It was also pointed out that the problem of in-year variability—with some disbursements not arriving until the end of the financial year—should in principle be easier to address, and that both that and improving longer-term predictability would respond to country leadership.

56. A presenter from a recipient country central bank raised questions about the potential impact of too much budget support aid on the exchange rate and

competitiveness (the "Dutch disease" issue). Others pointed out that the same consideration applies to many forms of project aid (and indeed other inflows such as remittances); that the cost may be modest when compared with the benefits of increased aid, particularly if aid flows are expected to continue over a long period; and that the issue could be addressed by addressing domestic capacity constraints (such as numbers of teachers) and making investments with a high import content, by liberalizing trade, and if necessary using aid flows temporarily to add to reserves.

57. The Deputy Finance Minister from a post-conflict country spoke about the importance of budget support in his country, where over 90 percent of public expenditure is financed by aid. PFM and the budget process has been much improved. But with less than a quarter of aid flowing through the budget there was too much duplication between donors, too much use of international contractors and consultants, too much expensive technical assistance producing few results, with outside contractors and NGOs outbidding local employers for staff. This led to some discussion of the need for criteria for providing budget support to fragile states, and the idea that project aid did not necessarily provide the best answer in these circumstances.

4. Aid Coordination and Conditionality

58. Presenters from the donor and research community suggested a number of issues for consideration, including the following:

- Where donors provide budget support, they should consider whether there is any need to retain other aid instruments. They should also be ready to accept country-driven and approved PAFs (as in Mozambique) as a basis for support. PAFs should include a limited number of process "conditions" (such as improvements in PFM); policy actions, which should be the subject of dialogue, not conditionality; and be set in a results framework that would determine long-term but not short-term aid allocation decisions. Other issues included graduated response mechanisms when conditions are not met; and performance indicators for donors. Conditionality can be regarded as a contract—and clarity of terms is important. But the terms—other than a few "showstoppers" —should have an impact only in the medium term. Results cannot usefully be assessed annually.

- Success depends above all on building trust between partners—with policy signals by recipients (such as reducing military spending), building local presence by donors, packaging, and "charisma" all playing important parts.

59. A recipient country participant stressed the importance of coordination among donors, the need to get rid of multiple conditionality from different donors, for governments to take the lead in this respect, and for coordination also within governments—sector ministries should recognize they are part of the government team and subject to budget constraints. An IMF participant described recent Fund experience with streamlining conditionality, stressing the need for pragmatism and to find what works best for countries and donors.

60. Many participant noted the importance of building trust—not just between donors and recipients but on many other dimensions: among donors (a particular issue for EU countries); between local and head offices; between finance and sector ministries (with global "vertical funds" greatly complicating this relationship); and between donor governments and their parliaments. Some noted the influence of trust and dialogue in donor choice of countries to support—probably more important than applying in-country conditionality; others noted the inherent tension between fostering the contacts needed to maintain trust and reducing transaction costs. Many commented on the dangers of trying to measure and assess everything annually, particularly progress in achieving final results—some assessments and decisions are better made over longer periods. In this context, it was pointed out that the difference between ex post and ex ante conditionality is not so great after the initial year of a programmatic operation. Several asserted that PAFs should be produced and presented by recipient governments and perhaps approved by parliaments as in Mozambique.

62. A World Bank participant spoke about progress with the Bank's review of conditionality. He noted changes already made—in the shift to programmatic forms of lending; in reducing numbers of binding conditions; and in setting World Bank operations in the context of budget support groups in many countries, with combined PAFs. For the future, it seemed important to highlight ownership, though not in a naive way; to reduce conditions/benchmarks to a few truly critical actions; to accept that support cannot buy reforms; and to accept roles for process, policy, and outcome benchmarks in different circumstances.

5. Concluding Panel Discussion

63. Panelists drew a number of central conclusions from the proceedings.

- While progress has been slow, we have come a long way for the Bank to be able to mount such a forum on budget support. But we are still learning how best to use the instrument.

- Aid effectiveness is the issue, with a strong message that budget support enhances effectiveness in achieving poverty reduction and growth. It provides a way to support key priority sectors without undermining budget integrity: an emerging issue is how to prevent sector and project support doing so.

- Trust is important and can be seen as a dimension of selectivity. Imposing conditions chosen from countries' own policy frameworks, which should be normal practice, does not signal lack of trust.

- Predictability is important and may point to making some decisions at longer than annual time intervals. Donors may have to take more risks in this respect—but recipient countries are also accepting risk from variability in budget support. (Short-term in-year predictability should be more easily solvable.)

- The search for ways to strengthen donor accountability for implementing Paris commitments to alignment and harmonization should continue—with a possible role for independent monitoring groups or regional mechanisms. More radically, could donor presence in individual countries be streamlined?

- Improved PFM is central. There is probably already sufficient donor support, but it needs better coordination/less duplication, with more recipient country leadership. Capacity building in this and other areas may require attention to public sector pay levels for key staff.

- Budget support has also revealed the need for improved monitoring and evaluation—with corresponding strengthening of country statistical capacity. While final results are not always a good basis for conditionality, their measurement—and tracking links with policy actions—has to be a key part of country dialogue.

- While conditionality has sometimes worked in the past, for example in supporting reformers in implementing fiscal discipline and exchange rate reform, it has not proved effective in strengthening performance in weak policy environments. The question now is to find ways to transfer the experience of strong reformers—the main recipients of budget support—to "mid" reformers. In weak performers, where policy is the main constraint to progress, budget support can also have a role. Further discussion is needed about the right balance between budget and other forms of support in different country circumstances.

- The Fund's support for sound macroeconomic policies sets the scene for budget support—but an increase in budget support can in turn pose challenges for macroeconomic policy, not only of potential "Dutch disease" but also of potential volatility of flows and of debt sustainability where some of the support is debt creating. The Fund is seeking to develop a form of signaling about the quality of macroeconomic policy that will be less of an on/off switch for donors; and also to make a stronger contribution in the field to the work of multi-donor budget support groups. It is also working on new proposals to provide support for countries subject to exogenous shocks.

G. Consultation with Middle-Income Countries, June 1-2, 2005, Washington, DC

64. On June 1-2, 2005, meetings were held at the Watergate Hotel in Washington, DC with the participation of senior government officials of middle-income countries (MICs), at the invitation of the Bank, as requested by the Development Committee. The meetings were chaired by Mr. Xavier Nogales from Bolivia.

65. Officials from the IMF, Inter American Development Bank (IADB), and World Bank were present to listen and answer any questions but not to participate in the discussions. Government participants included senior officials from Argentina, Azerbaijan, Bulgaria, Egypt, Equatorial Guinea, Jordan, Korea, Latvia, Lithuania,

Romania, Panama, Philippines, and Poland. Participants contributed actively to the discussions and agreed on a number of important lessons for the Bank's policy-based lending operations.

1. General Conclusions

67. Participants discussed and reached consensus on a number of issues. They noted that the conclusions agreed upon can be used as a foundation to prepare "Guidelines to Steer Conditionality on Policy-Based Lending to MICs."

68. The most important outcome is that government participants emphasized their strong support to develop sound policies in their countries and the important role that the Bank can play in helping shape such a policy framework. There was a common view that conditions should be ambitious, because of the importance of improving the medium-term policy framework and because in several cases the attraction of other resources, mainly from other development partners (e.g., the European Union or private investors) depends on having better frameworks. With this understanding, the main message from participants to the Bank is that there should be a shift from the concept of "Conditionality" to one of a "Country Accountability Framework" or —even better— to a "Partnership with the Bank" to further develop in each country an efficient policy mix and path, designed to guide and induce sound and efficient development processes.

69. If there is a partnership, then loan conditions should be seen as enablers. It is clear that the stronger the analytic capacity of a country, the fuller the partnership will be. In general, IFIs (a) need to be quite careful in countries of lower institutional and technical capacity; and (b) should not try to modify the reform design of a country or push it further, but rather become a partner in the policy dialogue for joint building of the reform.

70. Since in a crisis there is no time to discuss details, IFIs tend to take advantage of the situation and impose too many conditions, often in unrelated areas. Instead, IFIs should be light on conditions during a crisis and should allow the country to stabilize first. The IFIs should play an advisory role and fully respect the fact that the government should make the final decisions to ensure ownership. In countries with low capacity though, IFIs' technical assistance can help create the space to develop and discuss a reform agenda in greater detail. In those cases, however, there is a sense that the Bank tends to hire consultants to produce the analyses or recommendations that it was looking for on an "a priori" basis.

71. With regard to European MICs, there was a notion in the discussions that the Bank can be instrumental in transferring the transition experience of the more mature and experienced MICs to the less advanced economies. Also, a real contribution by the Bank could include advice on health systems and public administration reforms, as the EU and other development partners are not fully advanced in these areas. Furthermore, the catalytic and signaling role of the Bank needs to be emphasized; in particular, Bank conditionality should not only be feasible but should also take into account the conditionality from other institutions, particularly "neighboring" programs designed by

the IMF, so as to prevent wrong signals being sent to the markets on which MICs increasingly depend.

72. Nevertheless, to improve efficiency at the time of deciding on conditionality it is necessary that the Bank pay attention in the future to some critical aspects that would better encourage cooperation, accountability, transparency, and national institutional development.

- Policy frameworks should take advantage of and try to coalesce around longer-term goals, such as the integration and trade development needs of emerging European countries. In that case, many specific developments are required in relatively short-term frameworks (e.g., trade reforms, investor rights, grading mechanisms), but there are also considerable benefits for the countries concerned.

- The Bank's role—given its worldwide experience and direct knowledge of policy-based operations and processes—is seen as an important element in helping countries improve coordination with other development partners (multilateral banks, bilateral donors, and foreign investors), which in turn can help maximize economic and social benefits.

- Overall, participants highlighted the importance of reducing (a) contradictions among donors; and (b) the number of conditions as well as the number of Bank missions. The Bank can make a major difference, including by providing technical assistance to deal with institutional weaknesses, in the private as well as public sectors. The most pressing need is often to enhance the strength of government institutions. The greater the institutional strengthening, the greater the ownership of policies will be, and the greater government and country commitment to get results on a gradual and sustainable basis.

- For the MICs in the European region, the EU is currently in the lead, while the Bank often plays a complementary role. This can create some problems nevertheless, since the Bank is accustomed to being in the lead: it is important for the Bank to learn to play a secondary role. Also, when there is a large number of NGOs, the Bank can play a very important role in helping to coordinate actions and plans among NGOs and to maximize benefits in support to the countries and governments. In any case, the correct way to operate should be, in the end, for governments to be in control of decisionmaking processes.

- Finally, the Bank should avoid the temptation to base conditionality on a common list to be used worldwide. It should, rather, consult with the government to decide what is doable and critical in a given country situation. When there are serious problems, options should be identified and the government and the Bank should work together to agree on the best policy blend and path to follow. In some cases, even the use of prior actions might be inadvisable. What is fundamental, however, is that a sustainable path of policy reform is followed and that, despite pressures to advance as fast as possible, it is preferable to move slowly but surely.

2. Individual Issues

73. Participants discussed and reached consensus on the following individual issues on the application of conditionality on Bank policy-based lending.

a. Partnership and Program Ownership

- Support should be given only to programs or actions that are country-led and owned. "Ownership" is key to ensuring strong country commitment to a program and, thus, to successful and sustained implementation.

- In general, support should be based on actions that already have been decided by a country. The policy framework should clearly be decided by the government. A transparent way to ensure that government ownership is in place is that some actions related to the new policy framework have already been implemented. In some cases, nevertheless, the Bank may play a role in helping design the policy mix and strategy. In those cases, it should be underlined that setting conditions on the part of the Bank helps reformers introduce short-term measures, but as a rule, when the Bank has sought to promote structural and medium-term reforms by promises of support, efforts have not proved effective. Furthermore, one participant indicated that he was not happy with a prior action approach because of its image of imposition, preferring to speak of a partnership relationship achieving gradual progress.

b. Accountability

- There should be a clear accountability on the part of the government and, thus, an accountability framework against which progress can be measured. While the nature of the framework will vary according to country circumstances, it will typically take the form of a policy action matrix, setting benchmarks for actions and indicating links between actions and desired results. Policy matrices, however, can become very intrusive when they end up being extensive, as shown by surveys carried out on conditionality.

- The program should first be based on an accountability framework of the government to parliament and to society and, secondly, on an accountability framework to the Bank and to other development partners. However, it would be paternalistic on the part of Bank and partners if they appeared to be overseeing domestic accountability. To minimize problems, a shift is needed to ensure that the framework is understood and seen by all parties as a statement of government intent and not simply as a document negotiated with the Bank or other development partners.

c. Program Content

- The main way for the Bank to influence the content of country programs is through dialogue and not through imposition of conditions. Many government officials value the rich experience and knowledge gained by the Bank worldwide and encourage the Bank to share this knowledge with country counterparts. In the end, countries must choose, decide, and take full responsibility for their programs. (When programs succeed countries tend to underline "ownership." However, when programs fail for whatever reasons, countries tend to blame the Bank for bad design or imposition). Logically, no support should be granted if they do not. In any case, the Bank should make efforts to avoid prescribing the content of country programs and the accountability frameworks.

d. Parsimony and Selectivity

- It is essential to minimize the number of conditions agreed upon with a government if financial support is to be disbursed in a timely and effective manner. Thus, it is necessary to be selective—between sectors and projects—and clearly Bank support should be provided where it is likely to be most effective. In the Bank, the decisions of which programs are to be supported should be based on (a) an assessment of the government commitment to the policy reform program and the likely sustainability of the program to be implemented; and (b) an assessment of the likelihood that the policy path chosen by the government will produce effective development results. In cases when other agencies take the lead role, the Bank should play a complementary role and its policies should allow the Bank to do so without delays or creating conflicts with the leading agency.

e. Choice of Conditions and Benchmarks

- Actions already taken will usually give a more reliable indication of the sustainability of a reform process than just promises of future actions. When the government is really convinced about a policy package it will have no problems in going ahead with key actions, which in turn will help the Bank to commit itself to support the program. In this manner, the way is paved for a programmatic approach. However, if it happens that the government is not fully convinced about a policy package, the result will just be "imposition of conditionality." As a result, it is often better to base decisions about support on past actions rather than future plans, although even in this case it will be important to minimize the image of imposition.
- At the same time, support should normally be set in a medium-term framework. Short-term policy actions can be important, although it is important to recognize that many programs will take years to be implemented effectively. To ensure consistency, it is necessary that short-term actions set out in policy action frameworks should derive from longer-term strategies (e.g., a poverty reduction strategy).

- Process conditions and benchmarks are often as important as policy implementation benchmarks. In many cases, actions to improve public financial management or to strengthen institutions have proved to be a priority. In those cases, actions taken or progress in implementing institutional frameworks should be chosen as benchmarks rather than direct progress toward final outcomes, given the nature of institutional strengthening processes. In general, when final outcomes are distant, it is appropriate to set clear specific actions needed to advance toward the final outcomes.

f. Choice of Few Critical Conditions in Coordination with Partners

- It is important to focus attention on a very few conditions judged to be critical to success and achieving immediate development results. Recipient countries normally have capacity only to implement a limited number of reforms at any time. Country strategies, annual budgets, and the underlying analysis need to be comprehensive, but the choice of key actions to be implemented in the months immediately ahead should be highly selective.

- In this context, it is important also to work closely with other development partners giving policy-based support, to seek to keep focus in the total set of benchmarks set for a country. Different partners have reasons to wish to emphasize different aspects of a country's policies, with some lenders or donors, for example, placing a central focus on political and human rights conditionality.

- In ensuring coordination with other partners, the Bank should help to harmonize conditions and to avoid a "ganging up" of development partners. Participants in general saw a great danger—similar to the positions expressed in recent Paris conditionality consultations[3]—in the possible "collusion" of lenders, investors, and donors, since this effect could seriously undermine the sovereignty of a country. The Bank, therefore, should strive to play a very transparent harmonization role.

g. Predictability of Support

- There is a high premium on the predictability of policy-based support. The discussion at the meetings followed the IMF definition of predictability: "Are countries certain of what actions or results they have to ensure to obtain the agreed upon and needed financial support?" On this basis, they favored the elimination of any discretion of lenders on what conditions are or when or how they are to be deemed met; loan agreements should be clear and transparent about conditionality, defining an objective way to measure results and compliance. Ensuring critical cash flows from multilateral and bilateral

[3] World Bank Review of Conditionality: Consultation with Civil Society Organizations, Paris, February 4, 2005. The meeting was held at the World Bank office in Paris as part of a series of consultation with borrowers, civil society organizations, and donor representatives on the Bank's review of conditionality.

support is crucial to sustainability. Thus, conditions to be met must be both achievable and transparent.

- The advantages of adopting a programmatic approach should be considered, since support each year is based on actions already taken. On the other hand, where governments have to go to a legislature each year, there may be significant political and transaction costs, and in those situations, the costs of lack of transparency in loan agreements may be larger. It is therefore important to set transparent benchmarks to act as triggers for future support within a programmatic approach.

h. Monitoring and Evaluation

- Support should emphasize the importance of establishing transparent country frameworks for monitoring and evaluation of development results. Policy actions and the results they are intended to achieve should be capable of being measured and monitored.

- Countries should avoid having competing or even contradictory evaluation and monitoring systems. Comptrollers offices' and legislative evaluation offices' work should be used as much as possible, since it is important at the national level to avoid duplicating national efforts on project monitoring and evaluation. Efforts, therefore, should include strengthening of local monitoring and evaluation capabilities rather than developing or maintaining separate project units.

- The transparency and efficiency of monitoring and evaluation mechanisms will improve within a country when the country's own mechanisms become more reliable and acceptable. Strengthening accountability to parliaments—as well as to foreign lenders and investors—will enhance the image and credibility of government programs and institutions to all interested parties.

i. Harmonization and Use of Country Systems

- Decisions and disbursement of support should as far as possible be synchronized with country strategy and budget cycles. The Bank should cooperate with other donors to try to achieve a general move to such synchronization.

- Policy-based support should as far as possible be delivered through country systems. This applies not only to the use of country strategies and accountability frameworks as well as to related annual review mechanisms, as discussed above, but also the use of country budget, accounting, and procurement systems.

- Where these country systems need strengthening, the Bank should give priority to including support mechanisms in the CAS. Wider use of country systems is critical to strengthening ownership of reform programs and building domestic institutional capacity. Enhanced resource management, transparency, and harmonization of policies and actions with other development partners are by-products of adequate country systems. Country leadership in this respect is necessary and critical. Moreover, wider use of adequate country systems will help to introduce a needed element of mutual accountability.

j. Transparent Management of Financial Resources

- Transparency in the management of financial resources has gradually become more necessary. Not only borrowed resources need to be efficiently and transparently managed, but domestic fiscal resources as well.

- It is thus necessary that Bank development policy operations give sufficient emphasis and priority to enhancing country management of financial resources. Internal controls as well as independent and external controls/ audits should be enhanced and supported, not only for externally financed expenditures, but also for projects financed exclusively by domestic fiscal resources.

IV. WRITTEN COMMENTS AND SUBMISSIONS

74. The Bank has also received a number of written submissions in the course of the review, including:

- "Partnerships for poverty reduction: rethinking conditionality"—a UK government policy paper.

- "World Bank conditionality review—Nordic-Baltic position paper"—a paper submitted by the Nordic-Baltic countries.

- "Developing countries in the driving seat?"—a published exchange of views between Patrick Watt (Action Aid) and Jaime Jaramillo-Vallejo.

- A submission from Christian Aid, June 16, 2005.

- A submission from Oxfam International, June 14, 2005.

In addition, the Bank has taken account of comments on conditionality in a number of submissions made to the 2005 World Bank/IMF PRS review, including submissions from EURODAD, Oxfam, Cordaid/Novid/Wemos of the Netherlands, CIDSE/Caritas Internationalis, the Swedish government (in the form of a working paper), and UNDP.

75. ***The UK policy paper*** sets out five principles to guide UK aid relationships, and which the UK believes should guide the use of conditionality by the World Bank:

- ***Developing country ownership.*** The UK "will support nationally owned poverty reduction plans that take account of the views and concerns of poor people. We will not make our aid conditional on specific policy decisions by partner governments, or attempt to impose policy choices on them (including in sensitive economic areas such as privatization or trade liberalization). Instead we will agree with partners on the purpose for which aid is being given, and will agree benchmarks to assess progress. We will draw these from countries' own plans, where available, and these benchmarks will relate to the impact and outcome of countries' overall programs in reducing poverty, rather than to specific policies."

- ***Participatory and evidence-based policymaking.*** "Both donor and developing countries should be accountable, to their citizens and to the wider global community, for showing how aid is improving the quality of life for poor people. The UK supports participation and the use of evidence in policy-making, and will press for the use of poverty and social Impact Analysis (PSIA). We will also encourage national debate—including in parliaments—on the relative impact of different policy choices."

- ***Predictability.*** "Developing countries can use aid most effectively if they can rely on it as part of their long-term budget plans. The UK will seek to make aid more predictable by being clear in advance about how much aid will be given and the basis on which funds will be reduced or stopped. We will talk to partner countries before any interruption of aid, and will assess the impact that reducing or interrupting aid would have on the poor."

- ***Harmonization.*** "The UK will work with other donors to improve aid harmonization and limit the overall burden of conditionality. In particular, we will encourage the World Bank and the International Monetary Fund (IMF) to use conditionality in accordance with the principles in this paper; and will continue to press them to monitor and streamline their combined terms and conditions." The UK will "use analysis from the IMF and World Bank" in making its assessments but "an IMF or World Bank program going 'off track' will not automatically lead" to a suspension of UK assistance.

- ***Transparency and accountability.*** "Both partners—donors and developing country governments—should be committed to transparency, and should make public their decisions and the evidence on which they are based. The UK aims to increase transparency around the process of decision-making on conditions, the conditions themselves, and the process for deciding to reduce or interrupt aid. The UK will use conditionality to ensure that aid is not used corruptly or for purposes other than those intended. In giving aid we will also take account of countries' commitment to universal human rights standards and other international obligations."

76. ***The Nordic-Baltic Position Paper*** suggests five key principles to guide World Bank conditionality for policy-based programs: (a) strengthened ownership; (b) tailor

conditionality to borrowing country circumstances; (c) increase focus on outcomes; (d) reduce the burden of conditionality through improved coordination and harmonization; and (e) transparency for accountability, greater predictability of resource flows, and adequate response to inadequate performance.

77. ***Patrick Watt*** in his published exchange of views with the Bank recognizes that the Bank must have certain criteria for lending, and that the broad principles of sustainability, poverty focus, and monitoring and evaluation are appropriate, but suggests that "there is now a growing consensus that conditionality is wrong in principle, because it undermines local democratic accountability, and wrong in practice, because it imposes inappropriate policy solutions." He believes that the Bank continues to have an inappropriate policy-influencing role, not only through the use of conditionality, and that "what's problematic is the assumption—which underpins policy conditions—that the Bank knows best, and is a neutral arbiter in policy disputes. It is not. The Bank's Board composition, and the culture and incentives among Bank staff, mean that the Bank continues to play an unjustifiably intrusive and one-sided role in policy formulation in poor countries, with dismal results for the quality of policy and for poor people."

78. ***Christian Aid*** will "encourage the Bank to issue a statement of principle of its use of conditions saying it will cease to make its aid conditional on the implementation of controversial economic policies, such as trade liberalisation, privatisation and fiscal austerity. In summary, Christian Aid finds the Bank's use of conditions is flawed in several respects:

- In its pursuit of 'due diligence for aid effectiveness' the Bank has failed to recognise that there are alternative strategies for development and that the policies it is promoting have proven controversial in their impact on poverty reduction.

- The Bank must improve its country-specific analysis to consider the impacts of policy choices, not only of liberalisation but of alternatives.

- The Bank must be ready to support countries' use of flexibilities in existing trade agreements, including raising of tariffs.

- The Bank is not sufficiently accountable for its actions. It must improve public and parliamentary scrutiny in decisions regarding all loans and grants.

- The Bank's lending is not sufficiently demand-driven. Governments must have more space to set out what they need external financing for and to reject or renegotiate loans in light of this.

- The Bank is increasingly pulling its conditions and benchmarks from multi-donor budget-support negotiations, rather than through its own programme agreements such as the Poverty Reduction Support Credit (PRSC); it should therefore ensure that these negotiations are opened up to a wider group of domestic stakeholders.

- The Bank's involvement in harmonised donor frameworks has the potential to reduce the collective burden of donor conditions; however, the centrality of the IMF's macroeconomic assessment, predisposed as it is to excessively tight fiscal targets, has to cease. The Bank should not automatically suspend its aid should a county go off-track with the IMF."

79. ***Oxfam International*** emphasizes the following areas of concern:

- "The administrative burden of World Bank conditions is still excessive. The World Bank has so far failed to address questions about the 'aggregate' burden of conditionality—or that imposed by all donors—which we regard as the most important measure of the burden conditionality places on aid receiving governments. Previous reviews have concentrated principally on binding World Bank conditions in policy-based lending. The Bank must go further in examining non-binding conditions, and other means of policy influencing, across all types of loan agreement.

- Country 'ownership' is still not respected in practice. The way conditions are conceived and implemented continues to undermine domestic political processes and the formulation of national strategies.

- Independent assessments of the poverty impact of reform proposals need to be strengthened."

80. The following were among submissions to the 2005 World Bank/IMF PRS review:

- ***Oxfam International*** calls for the PRSP Review, conditionality review, and review of PRGF program design to be strongly linked. Oxfam also calls for "a substantial revision of the current conditionality system, in order to allow governments and populations of poor countries to determine their own development path and allow aid to contribute to poverty reduction." Aggregate conditionality should be streamlined. All structural adjustment-type conditionality, such as fiscal austerity measures, privatization, deregulation, and trade liberalization, should be abolished. "Conditionality should be restricted to requirements for financial accountability measures and broadly agreed poverty reduction and gender equity goals only. To ensure national ownership, any conditionality should be based on nationally developed programs, and should be open to public debate involving inputs from parliament, civil society groups, and other relevant actors in the policy making arena."

- ***EURODAD*** calls on the Bank and Fund to "stop imposing economic policy conditions on developing countries," and to "work harder to implement their existing commitments to reduce conditionality," producing an annual progress report on how well they are both streamlining conditionality, and allowing for submissions from other stakeholders, including donors, recipient governments, and civil society (both North and South). EURODAD also calls on the Bank and Fund "to begin to fully implement their policy of aligning their lending to national poverty reduction strategies, which have been genuinely produced in a participative manner with civil society and parliamentary input."

- ***Cordaid/Novib/Wemos*** call for a "drastic revision of the current system of conditionality. The most controversial conditions are those related to economic and other policy reforms. Conditions on financial transparency and budget implementation however, have the potential to enhance accountability to the population." They therefore propose to limit conditions to the last category.

- ***CIDSE/CI*** believe that the PRS approach is "substantially undermined by the continued imposition of IMF and World Bank conditionality which is not drawn from or aligned to national PRSPs." They endorse the proposal that "that conditionality should be derived from a reduced set of targets and indicators contained in PRSPs and that a mutually agreed and coordinated framework for monitoring donor and government performance be established in each country."

- ***The Swedish Government Working Paper*** proposes a number of principles to guide dialogue and conditionality in the context of PRSs. "Dialogue and conditionality should be:

  - coordinated with other donors
  - adjusted to national processes and cycles
  - open and transparent and based on principles stated in advance
  - as much as possible be based on a common agreed framework derived from the PRS
  - focused on results, and may be complemented by process indicators, such as certain reforms and passing of laws, especially in areas where results can be difficult to measure."

- ***The UNDP*** suggests that the Bank should be more forthright about contradictions between conditionality and national ownership and that it is "difficult to talk meaningfully about 'national ownership' of Poverty Reduction Strategies if the economic policies of most PRSs have already been determined by the conditionality imposed under IMF PRGF agreements."

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InWent Policy Workshop
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Partnerships for poverty reduction: rethinking conditionality, Policy paper prepared by the Department for International Development, United Kingdom, 2005

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Memo from Cordaid, Novib and Wemos to Marten de Boer, Ministry of Foreign Affairs, Netherlands, regarding PRSP Review Input, May, 2005

Oxfam International Submission to the World Bank/IMF 2005 PRS Review, prepared by Oxfam International, June 2005

All submissions are available on the World Bank's external website (search for "Conditionality" to look up the page for the review of conditionality).

This volume presents key findings of the World Bank's review of conditionality in policy-based lending. It documents the evolution in the Bank's approach to conditionality, takes stock of recent experience, looks anew at the Bank's practice and presents a set of good practice principles to guide future policy-based lending.

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