



DEVELOPMENT COMMITTEE
(Joint Ministerial Committee
of the
Boards of Governors of the Bank and the Fund
On the
Transfer of Real Resources to Developing Countries)



DC2005-0013
September 9, 2005

REVIEW OF WORLD BANK CONDITIONALITY

Attached for the September 25, 2005, Development Committee Meeting is a progress report entitled "Review of World Bank Conditionality."

* * *

REVIEW OF WORLD BANK CONDITIONALITY

**OPERATIONS POLICY AND COUNTRY SERVICES
WORLD BANK**

September 9, 2005

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

CONTENTS

Executive Summary	i
I. Introduction	1
II. Conditionality: Context, Modalities, and Approaches	3
A. Context	3
B. Modalities	4
C. Changing Approaches	5
III. Trends in World Bank Conditionality	7
A. Numbers	7
B. Content	8
C. Compliance and Quality	10
IV. Applying Conditionality	10
A. Implementation Challenges	11
B. Improving Coordination with Financial Partners	15
C. Scope and Specificity of the Policy Matrix	16
D. Aligning with Countries' Accountability Frameworks	17
E. Customizing to Country Circumstances	18
V. Key Messages of the Conditionality Review	19
VI. Good Practice Principles and Next Steps	21
A. Good Practice Principles	21
B. Next Steps: Implementing the Principles	26
Annex A. External Consultations for Conditionality Review	29
Annex B. Analytic Work for Conditionality Review	31
Figures and Boxes	
Figure 1. Average Number of Conditions and Benchmarks per Lending Operation, FY1980-2005	7
Figure 2. Trends in the Share of Conditions by Thematic Area, FY95-05	9
Box 1. Good Practice in Different Country Circumstances	26

REVIEW OF WORLD BANK CONDITIONALITY

EXECUTIVE SUMMARY

1. The 2005 review of the conditionality associated with the World Bank's policy-based lending¹ 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

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.

3. **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.

4. **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

5. **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

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.

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.

6. **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.

7. **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.

8. **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.

9. *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. A stocktaking of development policy lending planned for FY07 will provide an opportunity to report on the implementation of the good practice guidelines for conditionality.

REVIEW OF WORLD BANK CONDITIONALITY

I. INTRODUCTION

1. 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.

2. ***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.¹ 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).² 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.

3. ***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."³ 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,⁴ 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

¹ World Bank, *Review of World Bank Conditionality: The Theory and Practice of Conditionality: A Literature Review* (SecM2005-0390/7), DEC, July 2005.

² World Bank, *Review of World Bank Conditionality: Recent Trends and Practices* (SecM2005-0390/4), OPCS, July 2005.

³ *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.

⁴ 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).

conditionality was carried out in the context of reviews of Bank-Fund collaboration,⁵ and was coordinated with the IMF's review of its own conditionality.⁶

4. **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.⁷ 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 2005.⁸

5. **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

6. 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

⁵ 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 2001; *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 2004. The next review of Bank-Fund collaboration is expected for FY07.

⁶ 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.

⁷ 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, EUROAD, and Action Aid, June, 2005.

⁸ 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).

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

7. 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.⁹ 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.

8. ***Context of Conditionality: Selectivity Criteria.*** Conditionality applied at the level of the specific lending operation is distinct from other broader considerations in Bank lending.¹⁰ 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;¹¹ 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

⁹ World Bank, *Review of World Bank Conditionality: The Theory and Practice of Conditionality-A Literature Review* (SecM2005-0390/7), DEC, July 2005.

¹⁰ World Bank, *Review of World Bank Conditionality: Modalities of Conditionality* (SecM2005-0390/1), OPCS, July 2005.

¹¹ World Bank, *Results Focus in Country Assistance Strategies: A Stocktaking of Results-Based CASs* (R2005-0042), OPCS, February 24, 2005.

underpinnings, poverty and social impact analysis, environmental considerations, adequacy of fiduciary arrangements, and participatory processes.¹²

9. ***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.¹³ 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

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

11. ***Prior Actions and Tranche-Release Conditions.*** Policy-based loans can be structured as either single-tranche or multitranches operations.¹⁴ 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 *multitranches 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.

12. ***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.¹⁵

- ***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.¹⁶ Triggers represent a notional set of expected prior actions for future operations that are critical for achieving and sustaining the

¹² OP 8.60, *Development Policy Lending*, para. 3.

¹³ World Bank, *Review of World Bank Conditionality: Legal Aspects of Conditionality in Policy-Based Lending*, (SecM2005-0390/2), Legal Department, July 2005, para. 9.

¹⁴ See OP 8.60, *Development Policy Lending*, para. 14.

¹⁵ OP 8.60 requires that stand-alone single-tranche operations be embedded in a medium-term framework; see para. 14.

¹⁶ World Bank, *Programmatic Adjustment Lending Retrospective*, Report 26315, March 2004.

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.

13. **Conditionality in Investment Lending.** The Bank generally discourages the use of conditionality in investment lending.¹⁷ 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

14. 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.¹⁸ 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.¹⁹

¹⁷ See the guidance note *Disciplined Use of Conditionality in Lending Operations* issued to World Bank staff by OPCS on September 13, 2004.

¹⁸ 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.

¹⁹ World Bank, *From Adjustment Lending to Development Policy Lending: Update of World Bank Policy* (R2004-0135), OPCS, July 15, 2004.

15. ***Emergence of Programmatic Lending.*** The Bank is increasingly using a programmatic approach for its policy-based lending.²⁰ 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.²¹ 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.²² 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.²³

16. ***From Adjustment Lending to Development Policy Lending.*** In August 2004, the Bank issued a new operational policy statement for use by Bank staff.²⁴ 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 operational 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 operational policy are expected to reflect programs 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

17. 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”

²⁰ World Bank, *Programmatic Adjustment Lending Retrospective* (Report 26315), OPCS, March 2004.

²¹ See OP8.60, *Development Policy Lending*, para.14.

²² 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, March 2004.

²³ World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238) OPCS, May 26, 2005.

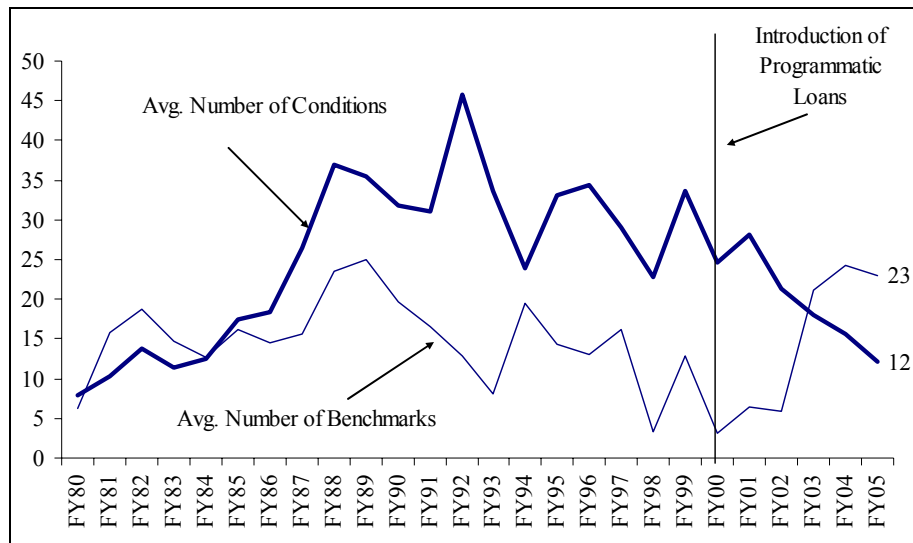
²⁴ World Bank, *From Adjustment Lending to Development Policy Lending: Update of World Bank Policy* (R2004-0135), OPCS, July 15, 2004.

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 future 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

18. 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).²⁵ This trend can be found in all Regions, and in all types of borrowing countries, whether IBRD or IDA borrowers.²⁶

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



Source: ALCID, World Bank.

19. **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 in FY05. 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.

²⁵ 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.

²⁶ World Bank, *Review of World Bank Conditionality: Recent Trends and Practices* (SecM2005-0390/4), OPCS, July 2005.

20. **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.²⁷ The framework for Bank-Fund collaboration introduced in 2001²⁸ 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.²⁹ 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 2000.³⁰ 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

21. The lessons of the 1990s show that generalized policy prescriptions often fail, and that there is no single model of development.³¹ Difficult institutional reforms such as privatization 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.³² 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.³³ These lessons are being reflected in the evolving content of conditionality.

22. **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

²⁷ World Bank, *Review of World Bank Conditionality: Recent Trends and Practices* (SecM2005-0390/4), OPCS, July 2005.

²⁸ 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 2001.

²⁹ See IMF, *Streamlining Structural Conditionality: Review of Initial Experience*, July 2001; and IMF, *Review of the 2002 Conditionality Guidelines*, March 2005.

³⁰ 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.

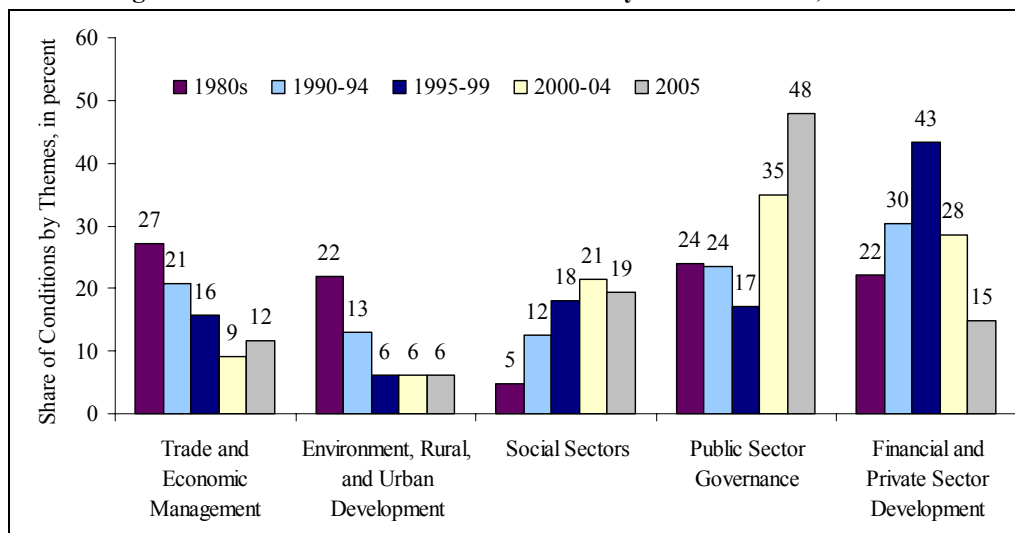
³¹ World Bank, *Economic Growth in the 1990s: Learning from a Decade of Reform*, 2005.

³² 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).

³³ D. Rodrik, "What Do We Learn from Country Narratives?" in: *In Search of Prosperity*, Princeton, N.J.: Princeton University Press, 2003.

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 for 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 as 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, FY80-05



Source: ALCID, World Bank.

23. ***Sensitive Structural Policy Areas.*** In particularly sensitive policy areas, conditionality has declined and now focuses more on long-term institutional issues.³⁴

- ***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

³⁴ World Bank, *Review of World Bank Conditionality: Content of Conditionality in World Bank Policy-Based Operations* (SecM2005-0390/5) PREM, July 2005.

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

24. Several indicators point to improvements in the development impact of Bank support through policy-based operations.³⁵ 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.³⁶ 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 37).

25. ***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

26. 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

³⁵ World Bank, *Review of World Bank Conditionality: Recent Trends and Practices* (SecM2005-0390/4), OPCS, July 2005.

³⁶ World Bank, *Review of World Bank Conditionality: 2005 Conditionality Survey* (SecM0390/3) July 2005. Survey results suggest that, although borrowers' overall evaluations of development outcomes are in line with OED's findings that improvements could be made in linking Bank activities directly to poverty reduction.

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

27. A critical lesson of the research on aid effectiveness is the importance of country ownership: financial partners can advise on and support, but cannot buy economic reforms.³⁷ Experience shows that development financing with strong conditionality but without strong domestic leadership and political support has generally failed to produce lasting change.³⁸ 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.³⁹

28. **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.⁴⁰

29. **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.⁴¹ 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

³⁷ 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.

³⁸ World Bank, *Assessing Aid: What Works, What Doesn't, and Why*, 1998, p.4.

³⁹ OP 8.60, *Development Policy Lending*, para 3.

⁴⁰ 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.

⁴¹ World Bank, *Review of World Bank Conditionality: Summary of External Consultations* (SecM2005-0390/6) OPCS, June 2005.

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.

30. ***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 that the Bank-supported program was well aligned with their country’s own medium- and long-term development strategy.⁴² 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.⁴³

2. *Predictability of Resource Flows and Performance Orientation*

31. In aid-dependent countries, unpredictable fiscal cash flows can lead to macroeconomic instability or inefficient expenditure allocation and execution.⁴⁴ 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.⁴⁵ 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.⁴⁶

32. ***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.⁴⁷ 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

⁴² World Bank, *Review of World Bank Conditionality: 2005 Conditionality Survey* (SecM0390/3) July 2005.

⁴³ 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.

⁴⁴ Bulir and Hamann, “Aid Volatility, an Empirical Assessment,” *IMF Staff Papers*, Vol. 50 No. 1 (2003).

⁴⁵ O. Celasun, and J. Walliser, *Predictability of Budget Aid: Recent Experiences*, World Bank, 2005.

⁴⁶ S. Koeberle, and Z. Stavreski, *Budget Support: Concept and Issues*, World Bank, 2005.

⁴⁷ *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.

the exact timing of resource flows but wanted clarity on the conditions to be met in multitranches operations and expected prior actions (or triggers) in programmatic operations.⁴⁸

33. **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.⁴⁹ 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.⁵⁰

3. Flexibility and Consistency

34. 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;⁵¹ 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.

35. **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.⁵² 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.

⁴⁸ World Bank, *Review of World Bank Conditionality: Summary of External Consultations* (SecM2005-0390/6) OPCS, June 2005.

⁴⁹ World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), OPCS, May 26, 2005.

⁵⁰ 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.

⁵¹ World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), OPCS, May 26, 2005.

⁵² World Bank, *Review of World Bank Conditionality: Summary of External Consultations* (SecM2005-0390/6) OPCS, June 2005.

36. ***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.

37. ***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.⁵³

38. ***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 policy operations.⁵⁴ Decisions on the loan amount and timing of programmatic operations are transparently reported on the basis of an assessment of progress against specific triggers.

39. ***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.”⁵⁵ 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.⁵⁶ 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.⁵⁷ A formulaic application of outcome-based conditionality could also reduce the

⁵³ World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), OPCS, May 26, 2005.

⁵⁴ 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.

⁵⁵ World Bank, *2003 Annual Review of Development Effectiveness: The Effectiveness of Bank Support for Policy Reform*, OED, 2004.

⁵⁶ European Commission, *EC Budget Support: An Innovative Approach to Conditionality*, February 2005.

⁵⁷ World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), OPCS, May 26, 2005.

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.⁵⁸

B. Improving Coordination with Financial Partners

40. 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.⁵⁹

41. ***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.

42. ***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.⁶⁰ 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

⁵⁸ 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.

⁵⁹ IBRD Articles of Agreement, Article 4, Section 10; and IDA Articles of Agreement, Article 5, Section 6.

⁶⁰ 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.

43. 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.

44. ***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.⁶¹ 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.

45. ***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.⁶² 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.

46. ***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.⁶³ 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.⁶⁴ 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

⁶¹ World Bank, *Review of World Bank Conditionality: Recent Trends and Practices* (SecM2005-0390/4), OPCS, July 2005.

⁶² World Bank, *Review of World Bank Conditionality: Summary of External Consultations* (SecM2005-0390/6) OPCS, June 2005.

⁶³ World Bank, *Review of World Bank Conditionality: 2005 Conditionality Survey* (SecM0390/3), July 2005.

⁶⁴ Thirty-three percent of survey respondents were from core IDA countries and 14 percent were from Africa, where most PRSCs are being implemented.

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 multitranches operations) or adapt triggers (in programmatic operations).

47. ***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 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

48. 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.⁶⁵

49. ***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.⁶⁶ 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.

50. ***Survey Results on Designing and Implementing Programs.*** Country authorities suggest that the Bank can improve in simplifying the preparation, negotiation, and implementation of programs.⁶⁷ 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).

51. ***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

⁶⁵ World Bank, *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238) OPCS, May 26, 2005.

⁶⁶ World Bank, *Review of World Bank Conditionality: Summary of External Consultations* (SecM2005-0390/6) OPCS, June 2005.

⁶⁷ World Bank, *Review of World Bank Conditionality: 2005 Conditionality Survey* (SecM0390/3), July 2005.

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

52. 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.⁶⁸ 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.

53. *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.⁶⁹ Despite obvious differences, middle-income countries also endorsed many of the concepts and possible best practices that emerged from these debates.⁷⁰ 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.

54. *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.⁷¹ 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.

⁶⁸ World Bank, *Economic Growth in the 1990s: Learning from a Decade of Reform*, 2005.

⁶⁹ S. Koeberle, and Z. Stavreski, *Budget Support: Concept and Issues*, World Bank, 2005.

⁷⁰ World Bank, *Review of World Bank Conditionality: Summary of External Consultations* (SecM2005-0390/6) OPCS, June 2005.

⁷¹ World Bank, *Good Practice Note on Development Policy Operations and Program Conditionality in Fragile States* (SecM2005-0353), OPCS, June 2005.

55. **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.⁷² The performance of such state or provincial governments can matter greatly for the country's macroeconomic stability, growth, and poverty reduction.⁷³ 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.⁷⁴ 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

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

57. **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 Bank's operational policy is consistent with a view that conditionality is not a coercion 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.

58. **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.⁷⁵ 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.

⁷² This includes most of the Bank's large borrowers: Argentina, Brazil, India, Mexico, Pakistan, and Russia.

⁷³ 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.

⁷⁴ World Bank, *Good Practice Note on Development Policy Lending: Subnational Lending* (SecM2005-0390/8) OPCS, June 2005.

⁷⁵ 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.

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.

59. ***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.

60. ***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.

61. ***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.⁷⁶ 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

62. 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.

63. ***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.⁷⁷ 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.

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

A. Good Practice Principles

64. 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,

⁷⁶ *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.

⁷⁷ World Bank and IMF, *2005 Review of the Poverty Reduction Approach: Balancing Accountabilities and Scaling Up Results*, forthcoming.

which will continue to guide the Bank's policy-based support.⁷⁸ 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).

1. Reinforce Country Ownership

65. 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.

66. ***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.⁷⁹ 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.

67. ***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

68. 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

⁷⁸ World Bank, *From Adjustment Lending to Development Policy Lending: Update of World Bank Policy* (R2004-0135), July 15, 2004.

⁷⁹ 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.

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

69. 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.⁸⁰ 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.

70. ***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 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.

⁸⁰ 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.

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

71. 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 future 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 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.

72. ***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.

73. ***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 triggers. To serve as conditions or triggers 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. 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

74. 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 37) offers useful lessons to 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.

75. ***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

76. 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.

77. **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.

78. ***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 help 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 views 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.

79. ***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

Table 1. External Consultations				
Date	Location	Host	Objective	Participants
<i>December 2004</i>	London	UK (DFID)	Feedback on concept of review	Donors, academics, aid agencies, and civil society organizations
<i>January 2005</i>	London	ODI/LICUS conference	Discuss conditionality in fragile states	Recipient governments, academics, donors, and NGOs
<i>February 2005</i>	Video-conference	World Bank	Discuss practice of conditionality with MDBs	Multilateral development banks
<i>February 2005</i>	Paris	World Bank	Consultation with CSOs	CSO representatives from developed and developing countries
<i>April 2005</i>	Berlin	Germany (BMZ/ InWent)	Consultation with selected borrowers and donors	Borrowing countries, NGOs from those countries, and aid agencies
<i>April 2005</i>	Washington	World Bank Spring Meetings	Consultation with LICs	Governments and parliamentarians of LICs
<i>April 2005</i>	Washington	World Bank Spring Meetings	Consultation with CSOs	CSO representatives from developed and developing countries
<i>May 2005</i>	Cape Town	World Bank/SPA	Exchanges on best practices in budget support	IDA borrowing countries, academics, and aid agencies
<i>June 2005</i>	Washington	World Bank	Consultation with MICs	Governments of MICs, MDBs
<i>January to June 2005</i>	Bank Website	Open consultation	Open forum for the review	General public
<i>May 2005</i>	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

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