# Comment on Asian Development Bank Policy-Based Lending: Performance, Results, and Issues of Design

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This comment focuses on three questions. (i) What are the issues affecting the development effectiveness of policy-based lending (PBL)? (ii) Does the chapter capture the issues well? (iii) What does PBL have to do with the Sustainable Development Goals (SDGs), which all member countries of ADB have signed up to?

## 1. What are the Issues Affecting the Development Effectiveness of Policy-Based Lending?

PBL provides rapid financing to governments along with support for a policy reform process. The chapter describes the trade-offs involved in this process very well. Financial support sometimes needs to be fast and large to have an impact, especially at a time of crisis. By contrast, policy reform is often a long slow process of incremental change and institution building. The two do not always co-exist comfortably. Over time, PBL has tended to address the finance objective more than the policy reform objective, as laid out in the chapter and evident in a greater reliance on prior reforms, shifting to PSM reforms within control of the ministry of finance (which has an incentive to deliver on reforms as it also gets to control the PBL money, as opposed to sectoral ministries), de-linking the loan volume from the difficulty or cost of implementation of the reform program.

This evolution of PBL may be positive, but it does change its nature. I believe the recent trend is positive for several reasons. First, it puts countries firmly in the driver's seat on the pace of reforms. As a development partner, it is appropriate for ADB to comment on and provide advice to counterparts on the nature, pace and sequencing of a reform program. It is not appropriate, in my view, to use financing to bolster ADB's own views over those of elected officials unless (i) there is a risk that the government program is so weak that a default could occur; or (ii) the economic context is so distorted that the loan could be "immiserizing".[1]

The chapter suggests that ADB should pay more attention to transport, energy and water infrastructure reforms, to align with areas where ADB has significant sectoral expertise. I am convinced ADB does have expertise in these areas that it can and should share with governments, but I would be reluctant to use the PBL as an instrument to force this. I subscribe to Martin Feldstein's critique of IMF operations during the Asian financial crisis, that the IMF strayed too far into structural reform territory during that time.[2] Adjustment loans are about providing liquidity, not an instrument for forcing, or, more politely put, encouraging, specific policy reforms. Of course, a series of PBL operations can be used to structure reform incentives in the right way, but that is more about the pace, sequencing and degree of difficulty of reforms, rather than about choosing one sector over another.

The second reason for supporting the tilt of PBL toward the provision of finance is that one lesson of crisis management is that "too little, too late" has long-lasting harmful consequences. What would be "too little"? That's a question not really addressed in the paper. It would be useful to have had some

[1] Tariffs, foreign capital and immiserizing growth
***Richard Brecher*** and *Carlos F. Diaz Alejandro*
***Journal of International Economics***, 1977, vol. 7, issue 4, 317-322.

[2] Martin Feldstein. 1998. Refocusing the IMF. *Foreign Affairs*. March/April.

discussion of whether ADB PBL always complemented IMF programs, although the chapter does contain a cryptic discussion of the need for ADB to have its own macroeconomic assessment capabilities. This may be correct, but a strong partnership, including shared analytical assessments, with other crisis lenders is possibly more important. Has ADB ever moved ahead in the absence of an IMF program or an IMF letter of comfort on the macroeconomic front? How often is ADB PBL part of a financing package to a government that also includes other development partners, notably the World Bank?

The chapter is correct in saying that the IMF is not the fount of all wisdom on macroeconomic matters, but developing an alternative capability, as the World Bank's rather mixed experience shows, will not be easy nor necessarily uniform across a large institution like ADB.

Data from International Aid Transparency Initiative indicates that ADB has one of the best track records of disbursement against commitments of PBL operations in response to COVID-19 among all the multilateral development banks (MDBs). That is a strong testament to the value of tilting towards finance.

The chapter correctly notes that it is hard, if not impossible, to develop a strong causal link between PBL operations and actual results, given that so many other factors also affect the results. I can only agree. One intermediate approach that some bilateral agencies follow in their multilateral assessments might provide guidance. Imagine a diagram where all ADB developing member countries are ranked along an X-axis in terms of the degree to which their policies and institutions in place align with ADB's strategic priorities (the seven operational priorities of Strategy 2030, for example), and a Y-axis that measures government effectiveness in implementation. It could be argued that PBL should be concentrated in the upper right quadrant (effective government, aligned policies). This could provide a framework for how to think about the allocation of PBL. It would also link PBL to issues such as climate change, the SDG agenda, and Strategy 2030 in a way that currently seems absent.

An approach like this offers some potential for cross-country differentiation. For example, there may be countries well suited to PBL, where finance remains important alongside country dialogue in a context where there is strong alignment between ADB management and government officials. Conversely, there may be countries where either the alignment or effectiveness is so poor that PBL should not be considered.

In future, I would anticipate that PBL will become even more important, partly because it provides a unique source of affordable, flexible, counter-cyclical, long-term development finance. The form may change towards greater pooled funding, including through country platforms (it would have been useful if the paper could have commented on the on-going pilots which will probably be supported by sector development program loans), but the strong focus on public finance will surely remain intact.

**2. Does the Chapter Capture the Issues Well?**

I found the chapter very well written and informative. My one comment is that more country differentiation would have been very useful. The paper is silent on, for example, the use of PBL in small island countries, a country grouping where ADB is trying to expand its operations and where issues of debt are very pertinent. It is also silent on the use of PBL in fragile and conflict-affected situations, another area where ADB lending activities are set to expand. The trade-offs that arise in these different contexts might be quite different from those discussed above.

**3. What does PBL have to Do With the Sustainable Development Goals?**

This is where the chapter is weakest. In fact, it does not address the SDGs directly at all. To link PBL with SDGs requires judgments on three questions: (i) the scale and ambition of ADB activities, (ii) creditworthiness assessments, and (iii) partnerships and country platforms.

*Scale and Ambition of ADB Activities*

PBL is the right instrument for tackling SDG-related issues, but it is currently deployed at too limited a scale. Achieving the SDGs will require a major effort in Asian countries if they are to transition toward green and inclusive economies, but ADB does not yet have the mandate or resources to play a transformative role, even in partnership with other MDBs.

In future, it would be ideal if ADB and other MDBs could use instruments like PBL to advance investments in sustainable infrastructure, digital transformations, human capital provision, social assistance, biodiversity, and conservation. To do this, ADB may have to identify ways of identifying SDG-related expenditures that could be supported by a PBL. This will provide some comfort both to ADB and to citizens in developing member countries that PBL funds are being well spent.

*Creditworthiness Assessments*

If PBL operations are used in this way, they will have to confront the issue of debt distress and appropriate volumes of preferred creditor loans, especially for countries that may have difficulty in accessing private capital markets. Of course, this will need to be done in a manner consistent with maintaining ADB's AAA rating, but many analysts believe that, even within these constraints, there are many opportunities for stretching balance sheets.[34]

*Partnerships and Country Platforms*

Unlike project lending, PBL is almost always undertaken in partnership with other financial institutions. The G20 Eminent Persons Group recommended piloting a number of country platforms, with the idea of coordinating national investment programs (sometimes sectoral) among various financial institutions (including in many instances domestic long-term investors such as national development banks and insurance and pension funds). These platforms would go well beyond donor coordination to include:  transparency; high environmental, social, and governance (ESG) standards; and standardized project preparation, documentation and templates. They would be designed and oriented toward specific SDG investments, probably on a sectoral basis to permit the development of critical expertise.

[3] See, for example, Chris Humphrey and Annalisa Prizzon, 2020, "**Scaling up multilateral bank finance for the Covid-19 recovery**," Overseas Development Institute, London;

[4] R. Settimo, 2019, "**Higher multilateral development bank lending, unchanged capital resources and triple-a rating. A possible trinity after all**?" Banca d'Italia Occasional Papers, No. 488