

Chapter 1

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

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1. Introduction

Policy-based lending (PBL) offered by ADB provides ADB developing member countries (DMCs) with fast-disbursing and untied financial resources. These loans are conditional on reforms agreed by the government and are designed to help meet budget financing needs, including the cost of the reforms.¹ Initially known as program lending, the modality was first introduced by ADB in 1978, although its purpose and design has changed significantly since then.² PBL initially provided liquidity (in a foreign currency) for countries in balance of payments distress, so its initial purpose was wholly crisis-related. The emphasis was on rapidly disbursing financial support to enable countries to purchase essential imports and to support macroeconomic stability, with little or no policy reform mentioned.³ However, conditions were soon added and, in 1983, PBL disbursement in ADB became explicitly linked to policy reforms, in line with the approach followed by other multilateral development banks (MDBs).⁴ Thus, in addition to crisis periods, PBL was increasingly used in non-crisis periods to respond to the financing needs of countries' development programs with funds disbursed against policy reforms.⁵

Change in Focus

Over time, PBL evolved to provide budget financing for development and its policy focus changed significantly. The focus during the 1980s on structural adjustment, reforms to trade and state-owned enterprises (SOEs), and the removal of relative price distortions and subsidies resulted in second-generation reforms designed to deal with long-run social and institutional issues, e.g., expanding access to essential public services and reducing poverty. In short, a more developmental approach was followed. This period also saw a move away from development-partner-driven reform agendas to an approach whereby development partners aligned their programs with country-driven development strategies and harmonized their practices with country systems, with governments firmly in the driving

¹ The term "financing" in this context encompasses grants and concessional loans in addition to non-concessional loans.

² ADB. 1978. *Program Lending*. Manila.

³ Funds were disbursed against a positive list of imports; in ADB's case, against the importation of agricultural inputs. However, as money is fungible, this practice was replaced over time by disbursing financial support against an agreed list of policy reforms.

⁴ ADB. 1983. *A Review of Program Lending Policies*. Manila. ADB reformulated its program lending to explicitly support policy reforms in this document. The reformulation included adding a policy matrix of required reform actions and a development policy letter that set out the country's intended reform program.

⁵ The link between the program size and the policy reform adjustment cost was, however, formally dropped in 2011, when it was decided to mainstream programmatic budget support "through determining the overall loan size based on the development financing needs of a country, with reference to specific elements of the development expenditure programs supported by the budget support (that may not include the costs of adjustment directly related to implementation of the envisaged reforms) and, where relevant, support provided by other development partners." ADB. 2011. *Review of Policy-Based Lending*. Manila.

seat. Toward the end of the 1990s, reforms in public sector management, private sector development, and the social sectors began to emerge and this moved the focus away from structural adjustment and from industry, energy, and agriculture policies. This reflected a shift in countries' agendas, as well as a growing realization on the part of the development community that social, political, and economic institutions are critical for the sustained implementation of sound policies and for growth and poverty reduction.

Programmatic Policy-Based Lending

The most significant change in PBL design was the progressive replacement of *ex ante* conditions by “prior actions”, i.e., policy reforms undertaken before loan approval. In the early days, PBL was limited to a single loan (a “stand-alone” loan) typically arranged into two or three tranches, with tranche release conditions specified up front. The stand-alone modality was increasingly replaced by programmatic PBL—a series of distinct loans (“subprograms”), each supporting reforms sequenced in time but linked by a common results framework. Programmatic PBL was introduced by ADB in 1999 but caught on relatively slowly. However, since 2008 it has increasingly become the norm. Under programmatic PBL, each successive PBL operation is approved only when the country has fulfilled certain prior actions. Policy reforms are completed before loan approval, and disbursement follows immediately. The introduction of programmatic PBL in ADB and other MDBs was mainly in response to the implementation problems associated with stand-alone operations with several tranches, a disproportionate number of which experienced significant delays to the disbursement of their final tranches. Policy reform waivers were often requested to ensure these final tranches could be disbursed, or the final tranche was cancelled, resulting in unfulfilled reform objectives. As a result, stand-alone PBL was not effective at meeting country financing needs or at supporting policy reforms.⁶

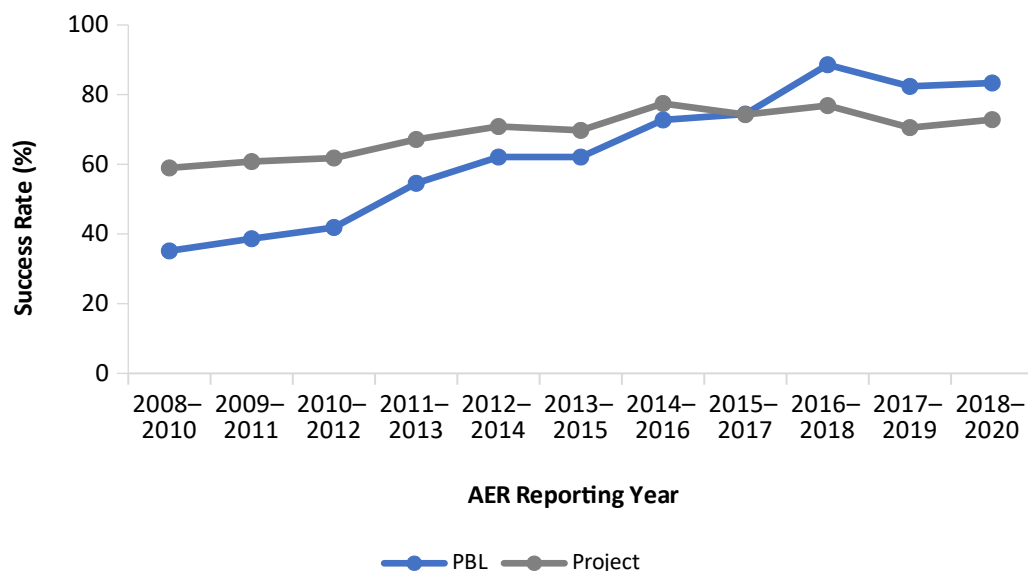
The progressive use of programmatic PBL by ADB was followed by a significant improvement in PBL success rates, a trend also experienced by other multilateral development banks.⁷ The ADB PBL average success rate in 2017–2020 was 83%, compared with 35% in 2008–2010.⁸ From 2016 to 2020, PBL success rates have outperformed those of ADB investment projects by a wide margin (Figure 1.1).

⁶ Operations Evaluation Department (OED). 2001. *Special Evaluation Study on Program Lending*. Manila: ADB.

⁷ PBL performance is assessed against the core evaluation criteria of relevance, effectiveness, efficiency, and sustainability. All of these contribute to the overall project success rating (IED. 2016. *Guidelines for the Evaluation of Public Sector Operations*. Manila: ADB).

⁸ Independent Evaluation Department. 2020. *Annual Evaluation Review*. Manila: ADB.

Figure 1.1: Performance of Policy-Based Lending and Project Sovereign Operations, 2010–2020



AER=Annual Evaluation Review

Note: Based on updated PBL ratings database

Source: Asian Development Bank (Independent Evaluation Department) database

Methodology

This chapter examines the various factors that have contributed to this remarkable turnaround in performance. To do this, it draws on an evaluation of PBL carried out by the ADB Independent Evaluation Department in 2018 (“the evaluation”),⁹ which aimed to assess PBL effectiveness by finding answers to three questions. (i) How responsive has PBL been to both country financing and policy reform needs? (ii) What development results have been achieved? (iii) How well has ADB designed, monitored, and measured policy reform outcomes? The rest of this chapter is structured around these three questions and the answers to them. Section 1 outlines trends in PBL use in the Asia and Pacific region over the evaluation period 2008–2017 as well as the types of PBL used by ADB and the policy reforms supported. It also covers ADB’s response to the coronavirus disease (COVID-19) pandemic in 2020 and 2021, which has far exceeded ADB’s response to the global financial crisis of 2007–2009 and the food crisis of 2007–2008. ADB’s COVID response has drawn attention to the utility of PBL as a leading crisis response instrument.¹⁰ Section 2 considers trends in PBL performance, including the increased use of single-tranche loans and the shift in policy focus from reforming the financial sector to public sector management, which has had a major impact on PBL success rates in validated project completion reports. Section 3 looks in detail at PBL design issues, especially the shortcomings in monitoring and evaluation frameworks which have made it difficult to assess what PBL has contributed to, or what difference the completion of prior actions made to achieving development outcomes. Section 4 draws conclusions and ends with the evaluation’s recommendations for ADB.

⁹ IED. 2018. *Policy Based Lending 2008–2017: Performance, Results, and Issues of Design*. Manila: ADB.

¹⁰ IED. 2012. *Real-Time Evaluation of Asian Development Bank’s Response to the Global Economic Crisis of 2008–2009*. Manila: ADB.

2. How Responsive is Policy-Based Lending to Country Financing and Policy Reform Needs?

PBL has two objectives: to respond to country financing needs, generally indicated by a fiscal deficit, and to support policy reforms. In practice, however, the balance between these objectives is not automatic. In crisis periods, for instance, the balance tips toward financing because the short-term need for fast-disbursing liquidity (in a foreign currency) to support macroeconomic stability trumps the long-term need for policy reform, as demonstrated by the recent response to COVID-19, which so far has been largely budget support.

This section argues that meeting country financing needs has been the primary objective of ADB PBL even in non-crisis periods, and that policy reform is the secondary objective. Policy reform is definitely an important objective, but for PBL to be effective in the policy arena it requires other inputs, including policy diagnostics and technical assistance, which go beyond budget support. These have not always been provided. Crisis periods have prompted ADB to introduce reform-free PBL variants.¹¹ For instance, in response to the global financial crisis of 2007–2009, the food crisis of 2007–2008 and more recently the COVID-19 pandemic, ADB has used reform-free modalities that support an increase in public expenditure as a countercyclical response to an economic downturn. The switch to single-tranche PBL over the evaluation period also signaled that more predictable and reliable financing was in fact the primary objective of PBL and that there may be a trade-off between financing and reform. ADB also engages in policy reform without the use of PBL, e.g., through covenants attached to investment project loans or stand-alone technical assistance.

Policy-Based Lending During Crisis Periods

Growth in demand for PBL was initially driven by economic crises. PBL approvals surged in response to the 1990 oil price shock, spiked again during the Asian financial crisis in 1997–1998, and increased significantly in response to the global financial crisis in 2007–2009 (Figure 1.2). Nearly half of all PBL (225 loans and grants, worth about \$27.1 billion) was approved in the 10 years from 2008 to 2017, with peak lending occurring around the time of the global financial crisis.¹² ADB's response to COVID-19 in 2020, over 90% of which consisted of budget support, has been the largest single spike in demand on record.¹³ However, as ADB sets a ceiling on PBL use at around 20% of overall sovereign lending, the other way it can respond to major crises is through the introduction of loans that are exempt from this ceiling and that do not necessarily contain policy reforms.¹⁴ In crisis periods, the share of these modalities in ADB sovereign approvals has increased sharply, showing that this type of lending modality primarily responds to country financing needs, which intensify during crisis periods, a finding common to other MDBs providing similar products.¹⁵

¹¹ In these PBL operations, reforms are substituted for countercyclical budget expenditures, which is also a policy response (a fiscal policy response).

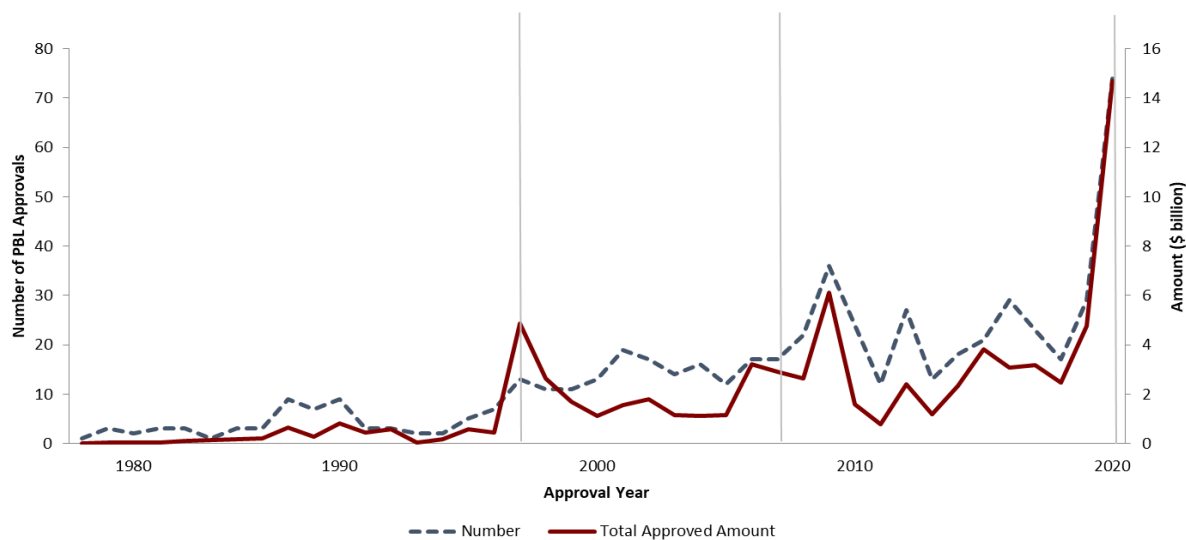
¹² From 1978 to the end of 2017 ADB approved 451 PBL loans and grants worth approximately \$55 billion.

¹³ PBL accounted for 55% of total ADB sovereign approvals in 2020.

¹⁴ In line with other multilateral development banks (MDBs), which limit PBL use either formally or informally, ADB sets a ceiling on PBL use as a share of total sovereign borrowing. Except for its specific crisis response instruments, ADB currently limits PBL use to 20% of total sovereign lending on a 3-year rolling average basis. ADB's PBL ceiling for concessional resources is an explicit constraint. While the introduction of crisis instruments in 2009 allowed ordinary capital resources (OCR) countries to borrow outside the ceiling, special dispensation was needed for countries eligible for concessional finance to do so because there was no such instrument for these countries. The policy does not set limits at the individual country level.

¹⁵ For instance, in response to the global financial crisis, development policy financing (DPF) by the World Bank increased to about 40% of commitments and disbursements over 2009–2010.

Figure 1. 2: Policy-Based Lending Over Time: Policy-Based Lending Approvals
(by number and value)



Note: First vertical line in gray corresponds to the Asian Financial crisis in 1997; second vertical line to the global financial crisis in 2007; and the third to the COVID-19 pandemic in 2020. Source: Asian Development Bank Controller's Department database.

Policy-Based Lending in Non-Crisis Periods

Some countries have used PBL consistently and extensively since its introduction and have grown to rely on it as a source of budget financing even in non-crisis years. Consultations with country officials have suggested that demand for PBL is expanding, and in some countries it is the preferred lending modality. Indonesia, Pakistan, the Philippines, and Viet Nam have consistently accounted for nearly 59% of all PBL approved by value since 1978. These countries continue to be the largest, most frequent, and most consistent PBL users. Apart from Pakistan, where there is a strong poverty argument to justify the use of PBL, the evaluation found that PBL is mostly used by larger, more capable, and more developed countries. In terms of the number of PBL operations, Pakistan has been the largest PBL recipient, followed by Indonesia. In 2008–2017, PBL accounted for 71% of ADB's sovereign lending portfolio in Indonesia and 57% in the Philippines. In terms of ADB regions, Southeast Asia has been the largest and most consistent user of PBL since 1978, accounting for nearly 40% of approvals by number each year and almost 50% by value. Central and West Asia accounted for 25% of total approvals, and South Asia for only 16% by value, despite its large reform agenda. The use of PBL in the Pacific region appears to be linked to crisis years: the Asian financial crisis (1997), the stock market crisis in the US triggered by the bursting of the dot-com bubble (2001), and the global financial crisis (2007–2009). Recently, ADB has used PBL to provide contingent financing operations in Cook Islands, Samoa, Tonga, and Tuvalu which have been used to build disaster resilience during non-crisis times and to release funds immediately following a natural disaster.¹⁶

The evaluation found that PBL is positively correlated with the size of fiscal deficits, and negatively correlated with GDP growth, suggesting that finance is the primary objective of countries requesting

¹⁶ PBL has been used to clear debt arrears, for example, in the re-engagement of development partner support for Myanmar see. ADB. 2012. *Proposed Policy-Based Loan Republic of the Union of Myanmar: Support for Myanmar Reforms for Inclusive Growth Program*. Manila.

PBL, rather than policy reform,¹⁷ even if the key motivation of ADB is policy reform. Frequent PBL recipients, including Indonesia and the Philippines, base their requests for PBL on their budget financing needs (this was confirmed during consultations with ministry of finance officials in both countries). In the Philippines, for example, the Treasury divides financing of the budget deficit between domestic currency (80%) and foreign currency (20%) financing. Foreign currency financing includes financing by MDBs, so the larger the deficit the higher the demand for PBL. In general, ADB PBL approvals have increased after countries experienced large fiscal deficits. Policy reform is an important motivating factor as well (certainly for ADB) but the size of PBL operations is not necessarily determined by the size or cost of a government's reform agenda and nor are such operations systematically triggered by the desire for reform. In the absence of a fiscal deficit, it would be difficult to justify PBL use, and policy reform would be better supported using other financing modalities.¹⁸

Despite growth in PBL use in crisis and non-crisis periods, the size of PBL in relation to gross domestic product (GDP) and as a share of budget financing has decreased since the 1980s. Asia has experienced rapid growth and poverty reduction over the last three decades and the significance of development assistance relative to GDP has fallen across the region, although less so in the Pacific. As a result, the average size of a PBL operation relative to a country's GDP has declined more than threefold since the late 1980s, reducing the potential effectiveness of PBL as a countercyclical device during a crisis, although some of the value of PBL as a market confidence building device may have remained. The capacity of PBL in high-growth economies to act as an incentive for policy reform may therefore also have diminished. Moreover, finance (the provision of liquidity) alone cannot achieve policy reform.¹⁹ Good policy making must be well-informed, supported by evidence-based analytical work, diagnostics, and continuous dialogue with stakeholders to build traction for reform. Hence, PBL should also come with technical assistance (TA) if policy reform is to be achieved, and ADB has learned to increasingly deploy TA alongside its PBL, on grant basis.²⁰

3. Types of Policy-Based Lending

ADB uses four PBL types: stand-alone, programmatic, countercyclical, and special.²¹ Within this group, there are also sector programs, which combine investment projects with PBL. Stand-alone PBL is a single loan usually configured into two or more tranches.²² Programmatic PBL is a series of single-tranche loans, each supporting policy reforms that are sequenced over time but linked by a common,

¹⁷ Two panel fixed-effects models were estimated by the evaluation. Model 1: $PBL_GDP_{it} = \alpha_i + \beta_1 Res_Imp_{it-1} + \epsilon_{it}$ and Model 2: $PBL_GDP_{it} = \alpha_i + \beta_1 FiscalDeficit_{it-1} + \epsilon_{it}$ where i indicates country and t indicates year. The dependent variable, PBL_GDP , is policy-based lending (PBL) as a percentage of GDP. Res_Imp indicates total reserves in months of imports. α_i is the country-specific effect. The sample period is 1990–2016. The regression analysis shows that PBL is negatively correlated with total reserves in months of imports and positively correlated with fiscal deficits. The results suggest that the use and the amount of PBL is determined by countries' financing needs at the macroeconomic level.

¹⁸ There is a view that higher demand for PBL in these countries also coincided with sharpened procurement and safeguard conditions attached to ADB investment loans, particularly in the first decade of the 2000s, and that some countries had negative experiences with the introduction and grade of these conditions, and therefore lowered their demand for infrastructure investment lending. Thus their demand for policy-based lending increased by default. However, the evaluation did not assess this view fully.

¹⁹ The Tinbergen Rule states that achieving multiple targets (or objectives) requires an equal number of instruments. Hence, the two objectives of providing finance and supporting policy reform requires two modalities: finance and technical assistance.

²⁰ For instance, from 2008 to 2017, 45% of all PBL had at least one TA project, 26% had two, 12% had between three and seven, but 17% had no TA.

²¹ New PBL types have also recently been established to respond to COVID-19.

²² Stand-alone can also be designed as a single tranche.

longer-term development objective. While both these PBL types can support reforms over the longer term, in practice they are very different loans, and this is discussed in more detail below. In contrast, the Countercyclical Support Facility (CSF) and special PBL (SPBL) are crisis-response instruments. Following a crisis, CSF helps finance a fiscal stimulus that aims to protect the most vulnerable during an externally triggered economic downturn. The newly introduced COVID-19 pandemic response option (CPRO) also supports a fiscal stimulus to help countries tackle the economic and social impact of the COVID-19 pandemic.²³ SPBL is used to support a country during a balance of payments crisis and until recently had never been used, despite being introduced nearly 3 decades ago.²⁴ In addition to these different PBL types, ADB also uses PBL as a precautionary instrument in case an economic or disaster-related crisis may occur. In this case, policy reforms are directly related to reducing risks, e.g., building disaster resilience, which may include strengthening economic and fiscal resilience, providing social safety nets, and carrying out disaster preparedness. The use of PBL as a precautionary instrument that can respond rapidly in the aftermath of a disaster was formalized by ADB in August 2019.²⁵ Precautionary PBL that anticipates the onset of a future economic crisis has not yet been widely used.

Stand-alone and programmatic PBL have inherently different approaches to loan conditionality.

Stand-alone PBL with several tranches is approved on the condition that the borrower undertakes policy reforms in the future, against which the loan is disbursed.²⁶ It creates more uncertainty than single-tranche PBL since borrowers need to carry out the policy reforms attached to the loan after it has been approved, which can make timing and disbursement of subsequent tranches uncertain. The further into the future the reforms are, the greater the risk, which reduces the capacity of the PBL to provide timely financial support. Previous evaluations have noted that stand-alone operations have often resulted in significant delays to disbursements, or that waivers have been sought when tranche release conditions were not met. Evaluations of ADB PBL in 2001 (footnote 6) and 2007²⁷ described how overloading the second and subsequent tranches with complex and numerous conditions had led to severe disbursement delays, waivers, and cancellations, which was also experienced by other MDBs (Box 1.1).

Box 1.1: Before 2008, Most Policy-Based Lending Disbursement Was Significantly Delayed

In 2001, an evaluation of Asian Development Bank (ADB) policy-based lending (PBL) found that nearly three-quarters of all PBL operations (which at that time were all stand-alone PBL with several tranches) experienced delayed disbursement, and 11% of the final tranches were cancelled, which limited the PBL's efficiency, and reduced the likelihood, and hence the effectiveness, of the ultimate reform objective being pursued. To allow governments to comply with loan conditions, the implementation periods of stand-alone loans with several tranches were often extended or conditions were waived. For example, the India Rural Cooperative Credit Restructuring and Development Program (2006) was extended twice, delaying the program by 3 years.^a In Indonesia, the Industrial Competitiveness and Small and Medium Enterprise Development Program (2000) closed 4 years and 9 months after program approval, with cancellation of the final tranche.^b The Banking Sector Reform Program in Lao People's Democratic Republic (2002) took 6 years instead of 3 to complete.^c The Governance Reform Program in Nepal (2001) was delayed by 3 years and the last tranche cancelled.^d The final tranche of the Bangladesh Good Governance Program (2007) was finally disbursed in 2018, some 7 years later than initially planned.^e Delays, followed by cancellations, were

²³ ADB. 2020. *ADB's Comprehensive Response to the COVID-19 Pandemic*. Manila

²⁴ SPBL was used for the first time in 2019, as part of an international financial package to provide balance of payments support for Pakistan.

²⁵ Available: <https://www.adb.org/news/adb-introduces-contingent-disaster-financing-natural-disasters>

²⁶ Although the first tranche in multitranche PBL is disbursed against policy actions already undertaken. Conditions in the second tranche are undertaken in the future.

²⁷ OED. 2007. *Policy-Based Lending: Emerging Practices in Supporting Reforms in Developing Member Countries*. Manila: ADB.

particularly common in Pakistan. A major restructuring of the Pakistan portfolio in 2007–2009 also contributed to PBL cancellations. Among the factors that contributed to the poor performance of stand-alone loans before 2008 was that the more complex policy conditions were backloaded into second and subsequent tranches, increasing the uncertainty of those tranches being disbursed. Nevertheless, in the case of the Bangladesh Good Governance Program, while some conditions were waived and disbursements were significantly delayed, the project was regarded as a success by ADB. Gradually stand-alone PBL with several tranches was replaced by single-tranche operations. This meant the completion of policy actions was now no longer in doubt and hence the success rate of PBL improved.

^a IED. 2015. *Validation Report: Rural Cooperative Credit Restructuring and Development Program in India*. Manila: ADB.

^b IED. 2010. *Validation Report: Industrial Competitiveness and Small and Medium Enterprise Development Program in Indonesia*. Manila: ADB.

^c IED. 2011. *Validation Report: Banking Sector Reform Program in Lao People's Democratic Republic*. Manila: ADB.

^d IED. 2010. *Validation Report: Governance Reform Program in Nepal*. Manila: ADB.

^e ADB. 2021. *Validation Report: Good Governance Program in the People's Republic of Bangladesh*. Manila: ADB.

Source: Asian Development Bank (Independent Evaluation Department)

To overcome the difficulties with stand-alone PBL with several tranches, around the turn of the century MDBs began making increasing use of single-tranche operations, either on their own or as part of a series of single-tranche loans in a programmatic series. ADB introduced programmatic PBL in 1999 and began to use it more frequently from the mid-2000s.²⁸ Policy actions in single-tranche PBL operations are completed before loan approval, eliminating the delays and cancellations associated with stand-alone operations, and increasing the likelihood of the PBL being successful. The share of stand-alone PBL in the ADB portfolio declined significantly over the evaluation period.²⁹ The shift to single-tranche PBL meant that loans could now disburse with certainty because policy reforms had been completed in advance. At the same time, the type of reforms supported also changed, and perhaps their ambition has also diminished. This is discussed in more detail below.

4. Types of Policy Reforms Supported

PBL has supported reforms across a broad range of sectors and policy areas in a variety of countries, from upper middle-income countries to fragile states emerging from conflict, countries impacted by natural disasters, and countries hit by the coronavirus pandemic. Over the last two decades, however, the focus of reform, in nearly all country categories, has shifted away from agriculture, natural resources, and rural development (ANR) to public sector management (PSM)—Figure 1.3. Before the late 1990s, on average 61% of the total number of approvals per year supported ANR, but lending for policy reform in agriculture has sharply declined since those days. In the period leading up to the Asian financial crisis, PBL support shifted to financial sector reforms³⁰ and, since the mid-1990s, ADB has used PBL mainly to support broad public sector management (PSM) reforms in such areas as public expenditure and fiscal management, public administration, economic affairs management,

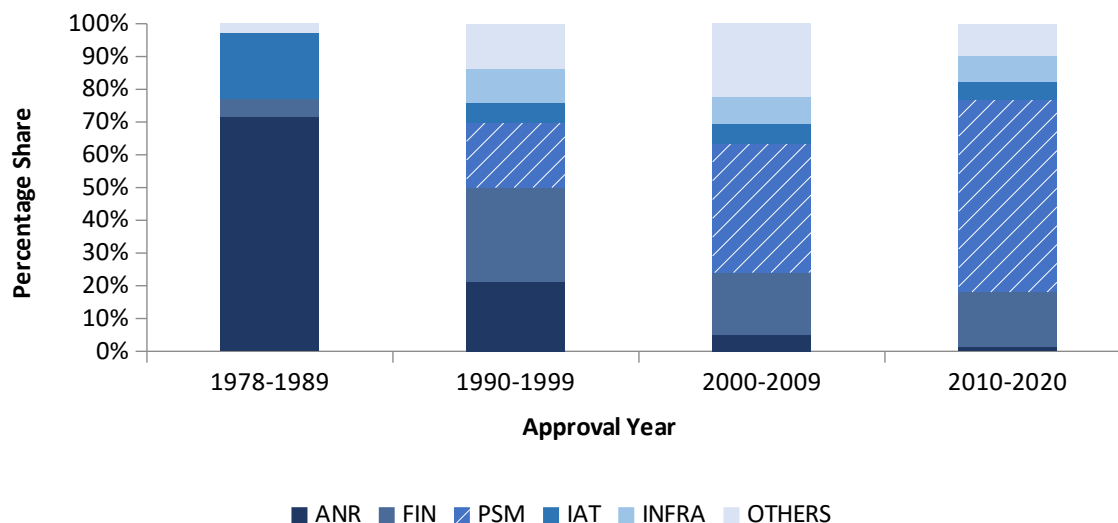
²⁸ ADB. 1999. *Review of ADB's Program Lending Policies*. Manila.

²⁹ In the post 2008 cohort of validated project completion reports, the number of multitranchise PBL operations fell by two-thirds from 61 to 22, while the number of single-tranche operations increased by the same proportion from 9 to 27.

³⁰ Financial sector reforms often overlap with PSM as the focus of reform is about developing appropriate financial market regulation, removing the state from bank ownership, or introducing appropriate policies for financial market development and competition.

decentralization, state-owned enterprises, law and judiciary, and social protection. The number of PSM operations escalated in response to the global financial crisis, as it did at other MDBs. PSM accounted for nearly two-thirds of all PBL approved over the evaluation period, peaking in 2008 (78%) and 2009 (87%) and PSM continued to be the focus of over 60% of PBL in 2010–2020 (Figure 1.3). In the first half of 2020, PSM accounted for 73% of all PBL approvals.

Figure 1.3: Reforms Supported by ADB Policy-Based Lending by Sector, 1978–2020



ANR = agriculture, natural resources and rural development; FIN = finance; PSM = public sector management; IAT = industry and trade; INFRA = energy, transport, and water and other urban services; OTHERS = education, health, information and communication technology, and multisector.
Source: Asian Development Bank (Controller's Department) database.

Surprisingly few PBL operations are to be found in ADB's key areas of investment—transport, energy, and water infrastructure—the areas in which ADB has most expertise.³¹ PBL operations in energy and the financial sector increased only in the last 3 years of the evaluation period 2008-2017. Recent approvals in the financial sector have focused on capital market development and improving the environment for private sector investment, rather than on the areas that appeared before 2008, such as privatization of state-owned banks or the appropriate policy and institutional structure for developing rural financial services. However, it is the relevant and changing role of the state in public service management and the delivery of essential services that is the focus of attention in policy reform and hence the areas of investment may be less important than arriving at a clearer understanding of why particular reforms are selected for PBL support. For instance, ADB selected capital market development as the focus for PBL support in Bangladesh, not transport or energy development, despite the fact that reforms were needed for longer-term investment sustainability in these areas.³² ADB also

³¹ This is not to say that ADB does not support sector reforms but, rather, that these are often supported through project interventions and not necessarily through PBL.

³² IED. Forthcoming. *Country Assistance Program Evaluation: Bangladesh, 2010-2020*. Manila: ADB.

selected capital market development in Sri Lanka, despite the fact that energy sector pricing was well below the cost of production and the tax ratio to GDP was among the lowest in the world.³³

In a limited number of cases, PBL is packaged alongside investment lending and TA into a sector development program. However, the use of this type of program, combining all three instruments in a single intervention, has declined since the early 2000s. Nevertheless, there are still examples of investment projects and PBL being used in parallel to help improve the policy context for investment projects. However, these are generally not packaged as an SDP. For instance, in Indonesia, ADB supports energy sector reform through a PBL operation without an explicit link to its energy sector projects.

Nevertheless, as mentioned above, given the scale of ADB investment in the development of infrastructure in the energy, water, and transport sectors in Asia and the Pacific, there is a notable lack of PBL-supported reforms in these sectors, even though infrastructure gaps were identified as key constraints on growth and poverty reduction in ADB's long-term strategic framework, *Strategy 2020*.³⁴ These are also areas where ADB has significant expertise and capacity to influence reform agendas and, given the scale of its infrastructure investments, one expects to see ADB capitalizing on its long-term engagement in these sectors. While ADB can address specific sectoral issues through covenants in investment loan agreements and through technical assistance, this may not be sufficient to remove binding constraints on growth in areas where political economy issues are deeply entrenched and go beyond the concerned sector. For example, the removal of consumer subsidies for energy, water, and transport requires broader engagement with central government agencies and other stakeholders.

5. What Results Have Been Achieved?

This section discusses the performance and results of ADB PBL, especially in those countries that have used PBL the most. Measures of PBL performance were drawn from project completion reports that have been validated by the Independent Evaluation Department (PVRs) while the broader focus on development results draws from evidence of achievements at the country level. The performance of PBL operations since 2008—as measured by the success ratings assigned by PVRs—has improved sharply compared with those approved before 2008.³⁵ Other MDBs have witnessed similar improvements. While several factors have contributed to the dramatic turnaround in ADB, two stand out: (i) the increasing use of single-tranche PBL since 2008, and (ii) the shift in the reform focus to public sector management, particularly public finance management.³⁶ Nevertheless, while the performance of PBL improved over the evaluation period, attributing country development outcomes to ADB-supported policy reforms is not straightforward, as is discussed in more detail below.

Shift to Public Sector Management Reforms

³³ IED. 2016. *Country Assistance Program Evaluation: Sri Lanka, 2006-2015*. Manila: ADB.

³⁴ ADB. 2008. *Strategy 2020. The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

³⁵ The evaluation portfolio is all policy-based loans approved and evaluated since 2008. Policy-based loans evaluated post 2008 are included in the sample even if they were approved before the period. The validated project completion reports of 49 PBL operations approved since the beginning of 2008 found that 80% were rated *successful*, almost twice that for the 70 PBL operations approved before 2008.

³⁶ The evaluation referred to five factors: including the high proportion of regular PBL in the portfolio that responded to the 2008–2009 global financial crisis, 93% of which were rated *successful*; the reduction in the number of policy actions; and a reduction in the share of Pakistan operations in the portfolio, a higher number of which were rated *unsuccessful*. These factors were trends in ADB performance data rather than structural changes in PBL design and reform focus.

As ADB began to use single-tranche operations, the PBL policy focus shifted to public sector management (PSM), as it did at other MDBs.³⁷ Nearly two-thirds of PBL operations by value approved from 2008 to 2017 supported PSM reforms, and nearly half of all evaluated PBL since 2008 supported PSM reforms. Hence, PSM became the dominant sector supported by PBL.³⁸

The performance of PBL supporting PSM reforms increased sharply over the evaluation period. From a success rate of 37% in 1999–2007, PBL-supported PSM reforms climbed to 88% in 2008–2017. One explanation for this is that those PBL operations that supported PSM concentrated on public expenditure and financial management (PEFM) with policy actions that were within the direct control of finance ministries, the major stakeholder in the PBL design. Of the 49 PVRs, 26 supported PEFM, whereas in the previous cohort only seven were PEFM-related. Furthermore, the types of reforms supported, while important for longer-term growth and development, became less politically controversial because they focused on technical areas that were within finance ministries' scope of work, e.g., reforms concerning budget preparation, the introduction of medium-term fiscal frameworks, and treasury management, which match the existing functions of finance ministries. PBL that supports the restructuring of state-owned enterprises, reductions in subsidies, or the adjustment of tariffs in energy or water are generally more politically charged and difficult to achieve, with the locus of action being in ministries or units outside the finance ministry's scope of influence.

Country Results

Despite the improvement in PBL performance, assessing results at the country level and linking these with ADB PBL interventions is not straightforward. This section looks at country results related to public sector management, particularly public financial management, which was the primary focus of PBL-supported reforms over the evaluation period. The majority of PSM reforms for which a PVR was available were in Pakistan (7); Indonesia (6); Viet Nam (4); India, Mongolia, Nepal, the Philippines, and Tuvalu (3 each); and Armenia, Georgia, and Samoa (2 each) while 14 further countries had 1 PSM-related PVR each.

Public sector management. ADB PBL interventions in India, Indonesia, Nepal, Pakistan, the Philippines, and Viet Nam aimed to improve public financial management systems at national and subnational levels, on both the expenditure and revenue sides. Reform areas included debt management, strengthening audit capacity, fiscal consolidation, and budget management. The objective was often to build resilience to future economic shocks, improve public finance management, and strengthen overall macroeconomic management. A common feature of PSM-related reforms supported by ADB in India, Indonesia, Nepal, Pakistan, and the Philippines was decentralization and strengthening of state-level public finance management, e.g., in West Bengal and Assam in India, Sindh Province in Pakistan, and broader decentralization processes in Indonesia and the Philippines. ADB also supported initial efforts to strengthen local capacity in Nepal. Decentralization was a common element of reform efforts in the PSM sector in these countries but less so in the countries that had limited PBL and for which only one evaluation report was available, making an assessment of performance in these countries more difficult to make. Further evidence of country results was found in IED country assistance program evaluations (CAPEs), Public Expenditure and Financial Accountability (PEFA) reports, and ADB country performance assessments.³⁹

³⁷ The use of single-tranche loans was recommended by IED in its 2001 evaluation (footnote 6). These were first used in Viet Nam in a programmatic series to support a World Bank poverty reduction credit support series.

³⁸ Its share of PBL approvals doubled from one-third of PBL approvals in 2000–2007 by value (30% by number) to nearly two-thirds from 2008–2017 (57% by number).

³⁹ The Public Expenditure and Financial Accountability (PEFA) program was initiated in 2001 by the European Commission, International Monetary Fund, World Bank, and the governments of France, Norway, Switzerland, and the United Kingdom. PEFA established a standard methodology for PFM diagnostic assessments, which report on the strengths and weaknesses of public financial management (PFM). PEFA provides a snapshot of PFM performance at

India. Project and country field evaluation evidence indicated that PSM support was closely linked to country priorities and strong government ownership. The program aimed to tackle fiscal imbalances, which had led to underinvestment in infrastructure and the social sectors and poor basic services. The India CAPE in 2017 regarded ADB's support as having been effective, as the major reform objectives and fiscal targets supported by the programs had largely been achieved.⁴⁰ However, several years after completion, some indicators, including capital expenditure levels, had regressed. The CAPE concluded that, given the state government's commitment to achieving fiscal consolidation, the results of the West Bengal PSM program were likely to be sustained. However, it was too early to assess the likelihood of longer-term results, such as the impact that public financial management (PFM) reforms would have on improvements to service delivery. A similar PBL operation in the Indian state of Mizoram did not have the same impact. The PVR for this program noted that the targets were ambitious and the capacity to implement the agreed reforms may have been overestimated.⁴¹

Philippines. The most recent IED assessment of the program in the Philippines found that ADB had directly contributed to major policy and institutional reforms, improved PSM, and laid the foundations for more business investment.⁴² PSM support contributed to the government's policy reform agenda and helped build capacity in revenue and public expenditure management, decentralization, and public-private partnerships (PPPs). The institutional strengthening for PPP was particularly evident, with a PPP center established, 80 improvements made to the legal framework, and a pipeline of PPPs established, which led to the implementation of infrastructure initiatives. ADB also supported a review of the Local Government Code, and at the time of the evaluation two bills focusing on local government revenue generation were before Congress. However, ADB's support for the judiciary and court administration had not been sustained. This long-standing support had stagnated compared with the early 2000s.

Indonesia. PBL supported the strengthening of audit functions, decentralization, public financial management, and public service delivery. ADB has been extensively involved in Indonesia's decentralization reforms, with a focus on financial management systems in regional governments. Although over half of public expenditure in Indonesia is now undertaken at the subnational level, the process of decentralization has produced variable results in terms of increasing citizens' access to local services. While there has been a general improvement and regional convergence in access to services, the quality remains poor and regional disparity is widening. Further reforms are needed to raise quality.⁴³ The World Bank's 2011 PEFA⁴⁴ assessment noted steady progress in strengthening the quality of PFM systems in Indonesia between 2007 and 2011, with some reforms in progress supported by ADB, the World Bank and other development partners.

Viet Nam. ADB's PSM efforts were largely focused on restructuring state-owned enterprises and improving the business environment. ADB targeted financial restructuring and equitization of several of the country's general corporations, which required substantial changes to laws, decrees, and

specific points in time using a methodology that can be replicated in successive assessments, giving a summary of changes over time.

⁴⁰ IED. 2017. *Country Assistance Program Evaluation: India, 2007–2015*. Manila: ADB.

⁴¹ IED. 2017. *Validation Report: Mizoram Public Resource Management Program in India*. Manila: ADB.

⁴² IED. 2016. *Validation Report: Country Partnership Strategy Final Review in the Philippines, 2011–2016*. Manila: ADB.

⁴³ World Bank. 2017. *Indonesia Economic Quarterly: Decentralization that Delivers, December*. Jakarta.

⁴⁴ World Bank. 2012. *Indonesia: Repeat Public Expenditure and Financial Accountability (PEFA) Report and Performance Indicators*. Washington, DC.

regulations. These reform efforts have been largely successful.⁴⁵ In 2017, the Ministry of Planning and Investment finalized a list of 375 state-owned enterprises to be wholly or partially divested by 2020.⁴⁶

Nepal. Initial PBL support for PSM reforms before 2012 was found to “have had modest results.”⁴⁷ However, a 2014 PEFA assessment suggested that Nepal had subsequently made substantial progress in deepening the structures and processes of PFM, particularly in the use of information technology. Investment efficiency gains had been achieved, despite a political transition period (2006–2010) during which reform was not a high priority.⁴⁸ This finding demonstrates that reform results may not be immediately visible, so longer-term monitoring outside the PBL timeframe is necessary.

Pakistan. PBL operations in Pakistan at federal and provincial levels were also weighted toward reforms in public sector management. There were few lasting or major results, however, because of the difficult reform context. The PEFA report showed that there had been positive improvements but only in some areas.⁴⁹ Consultations with government officials revealed that they saw the results of PBL more positively than the ADB evaluations, which had recorded very low success rates for all completed PBL operations over the evaluation period.⁵⁰ These officials felt that the incremental nature of the reforms that had arisen from numerous PBL operations was to be expected. The slow progress was at least partly the result of some sector reforms not being supported strongly enough by the government and its development partners. This was particularly the case for civil service reform and anticorruption initiatives, which were not directly tackled by PBL operations, or by national institutions. In this fraught political context, officials regarded incremental progress as sufficient justification for the programs. Overall, the PEFA showed that country systems for public financial management were improving, bearing in mind that improving PFM can take years, and that improvements to systems are not the same as improvements to public service delivery.

Number of PBL operations. ADB country performance assessments (CPAs) provide some evidence to suggest that, where ADB has provided five or more PBL operations, PSM and public finance management in countries eligible for concessional financing is improving. Scores for the country performance assessment (CPA) component (which measures the quality of governance and PSM) had improved in most countries eligible for concessional financing.⁵¹ The largest gains were in countries that had started from a relatively low base and received five or more PBL operations over the period, e.g., Cambodia and Lao People’s Democratic Republic. While reforms may be less effective once the quality of PSM has reached a certain level, countries with relatively well-developed systems that have received more PBL, e.g., Bhutan and Viet Nam, also achieved sizable positive changes. However, the

⁴⁵ IED. 2016. *Validation Report: Viet Nam Country Partnership Strategy Final Review Validation, 2012–2015, Linked Document. Assessment of Public Sector Management*. Manila: ADB.

⁴⁶ E. Cook. 2017. Vietnam Gears up to Divest State Owned Enterprises in 2018. *The Diplomat*. Asia.

⁴⁷ IED. 2013. *Validation Report: Country Partnership Strategy Final Review in Nepal, 2010–2012*. Manila: ADB.

⁴⁸ World Bank. 2015. *Public Expenditure and Financial Accountability (PEFA) Assessment: Nepal PFM Second Performance Assessment as of FY2013-14 (English)*. Washington, DC: World Bank Group. <http://documents.worldbank.org/curated/en/483831467998500044/Public-expenditure-and-financial-accountability-PEFA-assessment-Nepal-PFM-second-performance-assessment-as-of-FY2013-14>

⁴⁹ SPBL was used for the first time in 2019, as part of an international financial package to provide balance of payments support for Pakistan.

⁵⁰ Pakistan Federal Government. 2012. *Public Financial Management and Accountability Assessment*. Islamabad.

⁵¹ A country performance assessment assesses a country’s policy and institutional framework for promoting poverty reduction, sustainable growth, and how effectively it uses concessional assistance. Each country’s performance is based on a composite score constructed from the following: (i) an assessment of the quality of its macroeconomic management, (ii) the coherence of its structural policies, (iii) the degree to which its policies and institutions promote equity and inclusion, (iv) the quality of its governance and public sector management, and (v) performance of its concessional assistance project portfolio.

evaluation found no relationship between PBL use and the overall CPA score, because there are other factors that influence this result which are exogenous to PBL.

Capital market development. Countries that received significant support for capital market development had also achieved positive results. ADB has been a major partner of the government of Indonesia in the development of the financial sector that has taken place since the late 1990s. ADB programs contributed to results mainly in government bond markets, the Islamic capital market (*sukuk*), and the insurance sector. Similar results were found for Bangladesh, where ADB has supported capital market development since the late 1980s. In both cases, technical assistance also played a major role and it is difficult to determine whether reforms would have been undertaken in its absence. Nevertheless, since 2016, the capital market in Bangladesh has not developed to the extent envisaged and more reforms, including strengthening the market regulator, are needed to generate the desired longer-term development impact.

Transport, energy, and water. The PBL evaluation found less progress in PBL operations that supported reforms in transport, energy, and water—areas of significant ADB project investments. PBL supported energy sector reforms in the state of Assam in India,⁵² Pakistan,⁵³ the Philippines,⁵⁴ and Sri Lanka,⁵⁵ all of which have closed and been evaluated since 2008. Common issues included energy sector financing and political interference in pricing and supply. For example, the India country assistance program evaluation (CAPE) in 2017 found that, despite success in supporting the national electricity transmission and distribution network through project investments, cost recovery remained a concern (footnote 40). Support for energy sector reforms in Pakistan resulted in incremental improvements in the architecture, roles, and capacity of institutions, but the twin reforms of unbundling and privatization were incomplete.⁵⁶ Substantial progress was made in the Philippines in privatizing power generation and introducing wholesale competition, which reduced unsustainable subsidies to the sector.⁵⁷

Macroeconomic stability. Overall, country-level evidence suggests that PBL has contributed to macroeconomic stability and improved public financial management. It has helped reinforce macroeconomic performance and fiscal discipline, especially in crisis-affected countries. Budget support helped focus attention on public finance management and accountability processes, and more generally on broader PSM and governance issues. In most cases, significant progress was made in public financial management, as noted in PEFA assessments. There is also evidence that PBL provides a useful instrument around which development partner support can be better coordinated. However, the evaluation found less evidence to suggest that improvements were being carried through to improvements in human well-being, better service delivery and use of public goods and services, stronger governance, increased business confidence, or higher levels of investment and competitiveness, economic growth, and poverty reduction. This could be related to the weak theories of change that underlay PBL in PSM: ADB has not spelled out the relationship between the interventions and their impacts on the economy and society, nor are such impacts often recorded in PCRs. This could be because development outcomes are long-term and may not be observable at the time of program

⁵² ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Loans and Technical Assistance Grant to India for the Assam Power Sector Development Program*. Manila.

⁵³ ADB. 2000. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Islamic Republic of Pakistan for the Energy Sector Restructuring Program*. Manila.

⁵⁴ ADB. 2006. *Report and Recommendation of the President to the Board of Directors: Proposed Program Cluster and Program Loan to the Republic of the Philippines for the Power Sector Development Program*. Manila.

⁵⁵ ADB. 2002. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to Sri Lanka for the Power Sector Development Program*. Manila.

⁵⁶ ADB. 2015. *Country Partnership Strategy: Pakistan, 2015–2019*. Manila.

⁵⁷ IED. 2012. *Validation Report: Power Sector Development Program in the Philippines*. Manila: ADB.

completion. These complexities apart, the fact is that, overall, assessing the results of PBL in ADB is constrained by design issues, such as a lack of baselines and the absence of counterfactuals (i.e., what would have happened without the policy reform?), as well as by constraints on collecting country data and developing statistical systems. The fact that many policy reforms are now completed before loan approval raises issues about the value added by PBL and how its results can be evaluated. More emphasis needs to be placed on design features, which explains why recent MDB evaluations have focused on this aspect. Strengthening the design of PBL will not only help improve its impact but also support the collection of evidence to document intended and unintended results, enabling ADB's contribution to be better understood. For instance, PBL design depends on strong analytical foundations, the identification of quantifiable outcomes and indicators, and the selection of policy actions that are critical to the achievement of the development outcome. To measure the results of these policy actions, the PBL design needs to include a clear results framework that links policy actions with their intended results. The findings of this evaluation on design and monitoring issues are presented in the next section.

6. How Well has ADB Designed, Monitored, and Measured Policy Reform Outcomes?

The notable increase in PBL performance since 2008, as judged by the high success rate in project completion reports validated by IED, should indicate that these loans are very well-designed, especially in relation to policy reform. Nevertheless, because PBL is presented to the Board in the same format as an investment loan and, in turn, is assessed at project completion as if it were an investment loan, this has raised several design issues.

Macroeconomic assessment. First, like other MDBs, ADB relies too much on the IMF for its macroeconomic assessments, yet this assessment is rarely presented in the approval documentation because the investment loan template does not require it.⁵⁸ In Indonesia, for instance, none of the reports and recommendations of the president (RRPs)—the ADB approval documents—for PBL that were reviewed as part of the evaluation adequately assessed the macroeconomic framework or contained tables presenting key macroeconomic indicators or forecasts. In the Philippines, RRP for PBL typically discussed the size of the budget deficit and how an operation would help close the financing gap, but this was rarely linked to a macroeconomic assessment. In Bangladesh, PBL designs seldom contained a judgment on whether the macroeconomic policy framework provided a satisfactory backdrop for PBL use. Staff guidance on what constitutes essential aspects of the macroeconomic framework is not clearly set out in the ADB Operations Manual. None of the minutes of the management review meetings for PBL approved in 2016 for example, raised any issues in connection with the macroeconomic framework. Nor was the adequacy of the macroeconomic framework considered at project completion. The appropriateness of injecting liquidity (in a foreign currency) into the macroeconomic framework of a DMC is taken as a given at approval, supported by an attached IMF assessment letter, and completion. The evaluation found only one case where ADB's decision to proceed with a PBL was contrary to the IMF's position. This implies that ADB itself should maintain a robust capacity to evaluate the views of the IMF on the macroeconomic conditions of the country as part of PBL design. The IMF assessment letter cannot be definitive, as the decision to proceed with the PBL lies with ADB. The risk implied by the IMF assessment, including the reputational and precedent-setting risks of acting contrary to the IMF views, must be fully assessed, and borne, by ADB.

Political economy analysis. While a macroeconomic assessment should underpin the use of budget support, the policy reform side of a PBL also requires good analytical work and technical assistance.

⁵⁸ An IMF assessment letter no more than 6 months old attached as a linked document to the approval documentation (RRP) is generally considered to be adequate.

Good political economy analysis is also important for sound loan design. The evaluation found that, while PBL designs drew on available political economy analysis, such work was rarely undertaken specifically in designing PBL operations. As a result, the political feasibility of, and risks associated with, specific PBL-supported measures tended not to receive much focus. RRP for PBL operations in Bangladesh, the Philippines, and Viet Nam did not feature any significant political economy analysis, despite the substantial political risks involved. Similarly, in Indonesia, substantive political economy analysis was seldom part of the preparation for PBL, although interviews suggested that some analysis was done informally. Several programs in Pakistan would have benefited from political economy analysis. The sector analysis that was prepared for several ADB PBL-supported programs fell noticeably short of adequately assessing the economic and political dynamics that would be crucial determinants of ownership and commitment. Starting in the early 2000s, ADB built up significant PBL support to help shape local government systems and service delivery. The devolved social services programs (DSSPs) in Sindh,⁵⁹ Punjab,⁶⁰ and Balochistan,⁶¹ for example, sought to develop formula-based, performance-oriented grants to district governments, despite providing little evidence to show that the provincial governments were genuinely interested in reducing their discretion over the financing of local governments (one provincial government later went so far as to claim that the DSSP was developed over its objections). Similar problems plagued the implementation of many other provincial PBL operations. In hindsight, the design of ADB support for the devolution process in Pakistan was based on an insufficient understanding of the political economy risks involved and this was a key reason why the PBL operations from that time were rated less than successful.

Analytical work. The evaluation found that, while the majority of PBL appeared to be informed by analytical work, it was difficult to find clear references or links to the work that had been undertaken. Generally, the key conclusions of such analysis were not described in the RRP and in most cases references to the analysis that provided the rationale for the PBL were unclear. One reason why this information was missing is that the RRP template introduced in 2010 was not tailored to the PBL modality. In Bangladesh, for example, two of the five PBL programs (on urban public health and regional trade facilitation) did not appear to be based on detailed diagnostic work. The sector assessments underlying several of the PBL operations were very general and often did not point to specific policy actions or reforms. Without clear analytical underpinnings, it was often unclear how policy actions were derived or why they were selected. In several cases, there was too little prior analysis to adequately inform PBL preparation. This was particularly the case in Pakistan. It was therefore often difficult to assess how specific policy actions would help to address policy issues and constraints.

Quality of the results framework. The ability to evaluate the policy reform side of PBL ultimately depends on the quality of the results framework in the design document. In ADB this is known as the design and monitoring framework (DMF), which is an appendix to the RRP, and includes the logic (or theory of change) linking program inputs with outputs and outcomes and the results indicators selected. In some MDBs, the policy matrix itself (i.e., the list of policy actions to be undertaken), has gradually also become the results matrix. In ADB, the policy matrix and the results matrix (the DMF) are separated, so linking policy actions, the first step on the results ladder, with results (outputs and outcomes in the DMF) is not as straightforward as it could be.

⁵⁹ ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Program and Technical Assistance Loans to the Islamic Republic of Pakistan for the Sindh Devolved Social Sector Program*. Manila.

⁶⁰ ADB. 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loans and Technical Assistance Grant to the Islamic Republic of Pakistan for the Punjab Devolved Social Sector Program*. Manila.

⁶¹ ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loans, Technical Assistance Loan, and Asian Development Fund Grant to the Islamic Republic of Pakistan for the Balochistan Devolved Social Sector Program*. Manila.

The evaluation found several issues with the quality of the DMFs. Some of these related to basic attribution problems, which is a challenge for all MDBs. The use of very high-level outcomes in the DMF—e.g., GDP growth, levels of private sector investment, employment creation, and poverty reduction—which are influenced by many other factors exogenous to PBL reforms, limits any possibility of attributing significant changes in these areas to ADB-supported policy actions. Conversely, setting results that are too output-oriented, and which are identical or similar to policy actions, as some PBL operations do, is also a problem because it confuses inputs with intended changes generated by the policy actions, and may mislead the assessment of PBL results. Nor should the output and outcome statement be the same.

Assessing the quality of the DMF for PBL is complex. Finding clear links between the policy actions supported and the outputs and outcomes stated in the DMF is often difficult, especially when there are numerous, often overly process-oriented policy actions, with results that are unclear or difficult to measure in practice. Such policy actions can include the approval of a document, the submission of a document to cabinet, the approval of an institution’s organization chart, and staff training. The evaluation found that over 50% of policy actions were overly process-oriented, with results that were not measurable or only distantly related to the outcome. Moreover, the number of policy actions was correlated with loan size, suggesting that the ADB Board of Directors expected to see a greater quantity of reform effort with larger loans. However, the size of the loan is determined by country financing needs, not by the cost of policy reforms. Moreover, this approach indicates shortcomings in PBL design. Other MDBs have set a limit to the number of policy actions, usually 10 or fewer. The average for ADB PBL operations over the evaluation period was 23.

The evaluation also found that many policy actions had become outputs in the DMF or were listed as indicators for outputs. However, the problem with presenting policy actions as outputs in the DMF or as indicators of the output is that the result of the policy action is the policy action itself, which greatly reduces the credibility of achieving it. This can be seen in Table 1.1, where each indicator for the output is worded the same way as the policy action that was undertaken prior to loan approval. The result of all these actions, moreover, is not adequately captured in the output, which simply states that policies and actions are in place. The output and outcome statements are also similar. Even where the indicator for the outcome is achieved, it is difficult to attribute this entirely to the policy actions or to understand what the connection is. DMF outputs are achieved simultaneously with policy actions, making PBL successful on approval. A review of 49 PVRs of PBL approved since 2008 found that 20 contained policy actions that were used as equivalent to outputs in the DMF.

Table 1.1: Example of a Results Chain and Performance Indicators for Policy-Based Lending

Outcome: Framework for incremental policy and investment actions to improve air quality in the region strengthened	Fund disbursement rates for air pollution control measures increased to 80% for the central and provincial government and 90% for municipal governments (2014 base line: 71% for central government and 65% for provincial government)
Outputs: Policies and actions to reduce air pollution from key sectors issued and approved	<p>1a. Natural gas network expansion plan with time-bound investment approach to accelerate implementation issued by the provincial government</p> <p>1b. Enabling regulation to encourage capture of synthetic natural gas from coke oven flue gas and allow its injection into the natural gas distribution network issued by the provincial government.</p>

	<p>1c. Action plan for accelerated decommissioning of decentralized heat-only boilers and substitution with centralized combined heat and power plants with enhanced emission reduction measures issued the provincial government.</p> <p>1d. Policy on quantitative targets for raw coal reduction and promotion of centralized and non-coal-fired heating service adopted by all 11 municipalities.</p> <p>1e. Analysis of financial and market-based incentive schemes for urban and rural heating service from low-carbon and low-emission cleaner energy sources started by the engaged institute.</p>
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Source: ADB reports and recommendations of the President to the Board of Directors

Role of technical assistance. PBL design and implementation was widely, although not universally, supported by grant-financed technical assistance, which undertook analysis and supported the implementation of policy actions prior to loan approval. So, while the loan is absorbed into the countries' budget, TA is provided to the implementing agency to help implement policy actions. As some interviews suggested, provision of TA can provide an important incentive for line ministries to undertake reforms. In the Philippines, for example, TA was delivered as an integral part of PBL during 2008–2011, although more recent PBL implementation has tended to rely on existing or stand-alone TA. In the Kyrgyz Republic, a system support grant attached to the Investment Climate Improvement Program⁶² in 2008 helped set up an electronic single window for pre-customs clearance of imports and exports, clearly demonstrating how TA can help improve PBL design and implementation.

Slow delivery and underuse of TA undermined operational effectiveness in some cases. In Bangladesh, for example, the PCR for the Public Expenditure Support Facility and the CSF Program suggested that the failure to provide TA had undermined the achievement of some of the desired outputs.⁶³ The Viet Nam countercyclical support loan also did not draw on TA, which may help to explain the stop-go character of the government's stimulus program. In several of the Viet Nam programs, including the Third Financial Sector Program in 2007 and the Small and Medium- Sized Enterprise Program in 2010, TA came late or was ineffective.

Many of the available PCRs noted that a significant portion of TA funds—as much as 40% in some cases—remained undisbursed. In Pakistan, TA was provided in some form for all the PBL approved during 2008–2016 but was often marked by low use of designated funds. Where TA was provided to assess the impact of crisis support on households, for example in Armenia (2009), Georgia (2009), and Kazakhstan (2009), it was cancelled, which was a missed opportunity for learning. A comprehensive report on the overall impact of the Economic Recovery Support Program on vulnerable groups in Cook Islands was not undertaken, largely due to a lack of household survey data. Similar TA provided to support the government with state-owned enterprise reforms was cancelled in the Maldives (2009).

⁶² ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Program Cluster, Grant for Subprogram 1, and Grant Assistance to the Kyrgyz Republic for the Investment Climate Improvement Program*. Manila.

⁶³ ADB. 2012. *Completion Report: Public Expenditure Support Facility Program and Countercyclical Support Facility Program in Bangladesh*. Manila.

Other PBL operations had to add more TA to help reform objectives to be achieved. In the Marshall Islands, for instance, while the TA was fully utilized, its outputs were not fully achieved. Tax revenue increased but the approval of tax legislation (prepared with TA consultant support) remained pending in Parliament, so the reforms could not be fully implemented. Similarly, debt management and implementation of state-owned enterprise (SOE) reforms were also delayed pending approval of the SOE and fiscal responsibility legislation. The envisaged TA outcome of fiscal sustainability was not achieved because of continuing fiscal deficits. These reform objectives therefore had to be completed by additional TA even once the initial budget support had been completed.

The part played by TA in facilitating the achievement of policy actions is often not fully presented in project completion reports. A key issue is the extent to which the policy reforms that were undertaken could have been implemented with TA alone, i.e., without budget support. In Bangladesh, for instance, there were suggestions that TA was effective in supporting the Third Capital Market Development Program and reforms would likely have occurred without the need for, or incentive of, budget support. In nearly all cases, budget support is rarely undertaken without TA, further illustrating that finance and policy reform have separate purposes and require separate modalities. Moreover, policy reform is unlikely to occur with budget support alone; it also requires TA for good analytical work, diagnostics, and reform implementation.

7. Conclusions

IED evaluated the use of PBL by ADB over the period 2008–2017. The design and reform focus of ADB PBL fundamentally changed over this period and success rates—as judged by project completion reports validated by IED—more than doubled, a trend also experienced in other MDBs. Improved performance appears to have coincided with the growing use of single-tranche PBL and, with this, the use of prior actions that are completed before loan approval. These changes have substantially reduced disbursement risks and increased the capacity of MDBs to provide more predictable and reliable budget support in response to country financing needs, the primary objective of the instrument. A key issue, however, is whether the need to respond efficiently to country financing needs has encouraged support for less critical reforms. Certainly, over time, PBL reform topics appear to have shifted from more politically sensitive reforms such as reform of state-owned banks, to more technical reforms connected with public financial management. PBL modalities also changed as the second tranche of a single loan, often containing more difficult policy actions, had generally required waivers or had been cancelled. These were no longer part of PBL design. So there appears to have been a trade-off between efficient, rapidly disbursing modalities to meet country financing needs and policy reform, which suggests that the two objectives of finance and policy reform are not automatically compatible.

While PBL performance dramatically improved over the evaluation period, the evaluation identified several issues. For example, except for Pakistan, PBL tended to be used in the region's more developed economies and was rarely focused on reform areas concerned with infrastructure development, ADB's main comparative advantage. Moreover, it was difficult to reconcile the high success rates in project completion reports validated by IED with the evaluation's finding that there were shortcomings in the quality of PBL design. A key reason for this is that, while PBL performance significantly improved over the evaluation period, assessing country-level results, such as improved service delivery, better governance, greater business confidence, and poverty reduction, and linking these with ADB PBL interventions was not as straightforward. If there is doubt about attribution (e.g., whether the PBL outcome was the direct result of the policy actions taken), the responsibility often falls on the evaluator to prove this (e.g., by constructing a counterfactual to show whether the result would have been

achieved with or without the PBL). In practice, if the outcome indicators were achieved, the PBL will usually be rated successful, giving the role of PBL the benefit of the doubt.

Where budget support is delivered concurrently by several development partners, unambiguous attribution of outcomes to a specific donor or PBL operation can be almost impossible to establish. An alternative is to assess the additionality of the operation or its contribution to generating outcomes. In other words, the focus of evaluation should be on the quality of the whole of ADB's contribution, including TA, policy analytical work, and ongoing policy dialogue and other design matters. While attributing PBL's contribution to broader development outcomes is difficult, it is clear that positive outcomes are more likely if there is strong PBL design, including good quality analytical work underpinning the PBL's reform content, strong policy actions critical to intended outcomes, good quality technical assistance, and a clear monitoring and evaluation framework against which results can be assessed.

PBL remains an efficient modality for supporting DMCs through crisis periods. This was demonstrated by ADB's rapid response to the global economic and financial crisis in 2007–2009, and by the COVID-19 pandemic in 2020. ADB's use of PBL has spiked during crisis years and broken through the 20% ceiling imposed on this type of lending in the sovereign loan portfolio. The increase in PBL use was only possible through the introduction of reform-free and rapidly disbursing budget support modalities to finance DMC countercyclical public expenditure programs to mitigate the extent of the crisis. PBL played several different roles over the evaluation period. It supported countries through difficult periods, including economic downturns, natural disasters, and pandemics, and it supported broad public sector management and macroeconomic stability through non-crisis years. Other budget support mechanisms are also emerging, including results-based lending, which is more relevant to improving service delivery than PBL.

It remains difficult to attribute the economic growth and reductions in income poverty that has been observed in several countries in the Asia and Pacific region to budget support. This is partly due to a paucity of data, weak country statistical systems, problems establishing a causal chain, and difficulties establishing an appropriate timescale; the difficulty in attributing results to PBL does not mean budget support had no poverty impact or had less poverty impact than that of other forms of MDB support. More country-specific knowledge is needed on the links between budget support, policy reform (especially in public sector management), and growth and poverty reduction. ADB needs to strengthen its efforts to strengthen the quality of its design and monitoring frameworks and to better articulate the link between policy actions (the first rung on the results ladder) and development policy outcomes. A PBL operation needs to be founded on a strong results framework in which a small number of critical reforms are more clearly linked to desired outcomes to foster effective monitoring and evaluation. In the past, ADB may have been given the benefit of the doubt in success ratings where outcomes in DMFs are achieved, but the link to policy actions has not always been clear.

The evaluation published in 2018 made several recommendations, some strategic and others related to PBL design. At the strategic level, it recommended that ADB should make greater use of PBL to support policy reforms in sectors where significant project investments were also undertaken. This would enable ADB to help countries achieve more integrated and sustainable solutions to public policy problems in these areas. Although this recommendation was accepted by Management, in practice it is unlikely to materialize mainly due to the COVID-19 pandemic, which in 2020 led to higher use of the non-reform-based countercyclical support facility. If this continues, the opportunity to use PBL to support infrastructure-related policy reform is likely to be limited in the immediate term.

The evaluation's recommendation that ADB should develop an operational plan on the scope, objectives, and articulation of public sector management interventions was not accepted formally, but in practice ADB has made moves in this direction. An operational priority plan for governance and

institutional capacity has since been developed as part of ADB's Strategy 2030. This plan provides corporate guidance on the conditions under which public financial management loans should be provided.⁶⁴

The evaluation recommendations that (i) concessional assistance-only countries (Group A) should have access to a countercyclical facility, and (ii) the use of contingent disaster financing be formalized were accepted. Since the outbreak of COVID-19, countercyclical support has been expanded to include Group A and non-OCR eligible countries (Group B) as part of ADB's response to the COVID-19 pandemic.⁶⁵ The response includes using both Asian Development Fund (ADF) grant resources and ADB concessional loan resources as part of its COVID response. It is not clear whether this arrangement will continue after the current crisis period. Contingent disaster financing was formally approved by ADB soon after the evaluation was issued.⁶⁶

ADB did not agree to the evaluation's recommendation that, in rare cases where a regional department's view on the macroeconomic situation of a country diverges from that of the IMF, the risks involved be assessed independently of the regional department. Nevertheless, ADB has since strengthened the capacity of the Strategy, Policy, and Partnerships Department (SPD) to oversee PBL design prior to Board approval. SPD has revised the PBL provisions of the Operations Manual and the relevant staff instructions, which now include a specific loan approval template and a design and monitoring framework better suited to PBL. ADB's relationship with the IMF has been clarified and ADB's capacity to produce a clear macroeconomic assessment has been strengthened, helping to support the overall quality assurance mechanism for PBL. ADB Management decided against the recommendation of a separate 3-year PBL operational review such as the one produced by the World Bank, which may have helped to ensure a greater focus on results.⁶⁷

ADB has taken steps to strengthen PBL design. The evaluation recommended that ADB limit the use of process-oriented actions and articulate policy actions as substantive outputs. It recommended tailoring the DMF so that policy actions, outputs, and outcomes are more clearly linked, and that the analytical work underpinning PBL design and policy actions is clearly referenced. While these recommendations are part of the revised Operations Manual and staff instructions, the outbreak of COVID-19 and the need to respond quickly to DMC financing needs during the pandemic has meant that implementation of these changes has been deferred.

In due course, ADB needs to strengthen its assessment of PBL design at program completion. This assessment should cover: the justification for the use of PBL, the relevance of the policy reforms supported, and their significance to the development outcome. There should also be a greater focus on the role and quality of TA, given its central role in the preparation of a lot of PBL and its implementation. Just as PBL requires its own template and DMF, new approaches for assessing PBL performance need to be introduced to ensure that the success rating given to completed PBL is based on a robust evidence-based assessment of the design, especially with regard to the relevance and criticality of policy actions to development outcomes. In single-tranche PBL, policy actions have already been carried out at the time of the approval of the loan by the ADB Board, but their relevance and criticality to the outcome should still be assessed at completion.

This chapter regards ADB management's response to IED's recommendations as generally positive. Several initiatives to strengthen PBL design are underway. SPD, which oversees PBL quality and design, has strengthened its procedures. A separate PBL loan template, and a new results framework,

⁶⁴ ADB. 2019. *Strategy 2030. Operational Plan for Priority 6. Strengthening Governance and Institutional Capacity 2019-2014*. Manila.

⁶⁵ ADB. 2020. *ADB's Comprehensive Response to the COVID-19 Pandemic*. Manila.

⁶⁶ ADB. 2019. *Contingent Disaster Financing under Policy-Based Lending in Response to Natural Hazards*. Manila.

⁶⁷ World Bank Group. 2015. *Development Policy Financing Retrospective. Results and Sustainability*. Washington DC.

linking policy actions with their intended results, have been developed. The COVID-19 outbreak in early 2020 led to a surge in countercyclical budget support in the first half of that year and the introduction of a new type of PBL to enable ADB to respond quickly to those countries most severely affected by the pandemic. A revised project completion template which more closely examines design issues is yet to be developed.