

Chair's Summary for the 02 July 2018 Meeting

Policy-Based Lending 2008-2017: Performance, Results, and Issue of Design

1. The Development Effectiveness Committee (DEC) discussed the Independent Evaluation Department's (IED) Corporate Evaluation on ADB's policy-based loans (PBLs) covering the period 2008 to 2017. This study is relevant to ADB's ongoing exercise to finalize its Strategy 2030, as well as to members who use PBLs.
2. **IED Findings and Recommendations.** This review is the first PBL evaluation conducted by a multilateral development bank that attempts to assess the results. Previously, only bilateral aid institutions evaluated PBLs. The review found that PBL is an important modality; it provides fast-disbursing financial support for members to undertake policy reforms. It also allows ADB to help shape the policy reform agenda in Asia and the Pacific. From 2008-2017, PBL demand (181 PBLs) and volume (\$27.1 billion) grew, and performance improved significantly due to the greater use of single-tranche PBLs, a decrease in the number of policy actions, and change in country distribution of PBLs, among others. PBLs delivered positive results in Public Sector Management (PSM) and capital market development.
3. The review identified strategic and operational challenges in PBL design. At the strategic level, PBL concentrated in developing member countries (DMCs) with higher incomes per capita and greater institutional capacity. Moreover, PBLs increasingly concentrated on PSM, with less PBL use to support policy reform in ADB's traditional areas of investment and expertise, e.g. transport, water, energy, etc. PBL use increased during crisis years, which changed the balance between crisis support and policy reform.
4. The evaluation also found design challenges, such as (i) difficulty in attributing results to PBL; (ii) PBL size is related to the DMC's financing needs and not to the depth of policy reform; (iii) PBL contained a large number of process-oriented policy actions, making the role of policy actions unclear to achieve development results; (iv) the link between policy matrices and design and monitoring frameworks (DMF) to clarify results was weak; (v) insufficient assessment of policy actions' role in achieving outcomes in Program Completion Reports; and (vi) insufficient independent review of PBLs beyond the regional departments.
5. The review recommended (i) greater use of PBL in sectors with ADB investment loans; (ii) development of an operational plan (OP) on the appropriate scope, objectives, and articulation of PSM interventions; (iii) access to countercyclical support facility (CSF) for concessional assistance-only countries; (iv) formalizing the use of contingent disaster financing; (v) independent risk assessment in case of divergence from IMF's view; (vi) strengthen PBL design by limiting the use of process-oriented actions, tailoring DMFs to clearly link policy actions with outputs and outcomes, and clearly reference analytical underpinnings of policy actions; and (vii) strengthen assessment of PBL design at completion by improving quality assurance mechanisms.
6. **Management response.** Management reaffirmed its commitment to continuous improvement of PBL. It raised reservations about the evaluation methodology, including the use of the theory of change as a one-size-fits-all measure of PBL performance. Management and staff collaborated closely with IED at the start of the evaluation and through to the report's

finalization that helped fill information gaps and correct factual errors, however few concerns remain. The discussion on Georgia, Pakistan, and Tajikistan remains partial, negative, and in part factually incorrect.

7. Despite PBL concentration in more developed DMCs, there is no evidence suggesting the need for PBL rationing for smaller and weaker DMCs since the PBL ceiling is rarely breached. Assessing the quality of PBLs based on the number of policy actions is inappropriate as staff needs flexibility in responding to the policy reform priorities and requirements of DMCs. The content of policy actions is as important as their number.
8. Management agreed with the recommendations, except for recommendation no. 2. Management did not see sufficient justification in the report for developing a PSM OP. The concept of a PSM OP was explored years ago by the governance thematic group and was not finalized because PSM is a large and complex field that cuts across sectors. Different country contexts and circumstances also make it extremely difficult to come up with a viable PSM OP. Alternatively, developing policy notes or learning products on select PSM fields may be more practical and useful. And as part of Strategy 2030 implementation, ADB will develop an operational framework on governance and capacity development to guide ADB operations, including in the areas of PSM.
9. On recommendation no. 5, ADB works closely with and has strong cooperation with development partners (including IMF) during PBL preparations, with only two (out of 181) cases of divergence of views on borrowing countries' macroeconomic conditions noted in the report.
10. **DEC Discussion and Comments.** DEC noted the strong interest from the Board in PBLs and in this evaluation. Expanding PBL use to traditional ADB investment sectors should be considered on a case-by-case basis, as removal of binding constraints for sector development can be achieved by other measures. While PBLs work well in DMCs with strong policy frameworks, capacity and institutions, PBLs may be needed to support DMCs with weak institutions to build capacity and strengthen institutions. However, such PBLs may have to contain more process-oriented policy actions.
11. Several DEC members noted that PBL designs should drive reform through policy triggers and actions, with focus on achievement of policy outcomes, while recognizing the need for process-oriented policy actions still required by some member countries. Increased attention should also be given to technical assistance and capacity building needs.
12. PBLs with process-oriented policy actions may be justified for DMCs that are early in the reform process, have limited capacities, or need to start politically-sensitive reform, and need to map out a sequenced reform program, with the intent to deepen or evolve over time to a high impact reform.
13. PBL use in higher-income DMCs is varied and multidimensional, including access to quick-disbursing facility, policy reform support (reward for accomplished policy reform), and/or countercyclical support during crisis. PBLs help to address DMCs financing needs (usually reflected in PBL size), but in many cases, also to pursue reform requirements (including governance, investor assurance, and transparency). Depending on the design, PBL funds can act as an incentive for future reforms, past reforms, or to catalyze ongoing policy actions. The loan amount is not based on reform costs but is determined by the development financing needs of the country at the broad macroeconomic level.

14. DEC discussed the proposal to create a crisis window for Group A (concessional-assistance only) DMCs and noted that this is a matter for ADF donors to consider during the ADF mid-term review. DEC also supported the proposal to formalize contingent disaster financing for natural disasters. Management is reviewing the Disaster and Emergency Assistance Policy, which can be amended to formalize contingent disaster financing.
15. DEC suggested that management implement all the agreed recommendations; the proposed strategic operational plan was welcomed by some DEC members.
16. Early and more frequent board involvement in PBL preparation and approval were suggested, including at the concept note and policy dialogue stages during the annual country programming missions (compared to CPS discussions which are held every five years). Non-regional board members will provide detailed suggestions for discussion to management on board involvement in PBL.
17. While agreeing to maintain IED's independence, DEC raised concerns about the disclosure and communication of IED's reports, noting that descriptions of member countries be done more carefully, and that management's response be submitted to DEC and simultaneously disclosed with IED reports for a holistic presentation of the subject under evaluation. DEC agreed to review the IED disclosure and communication policy and consider the Board Compliance Review Committee's practice/policy. Some DEC members raised concerns that management response was provided one week before the meeting, constraining thorough discussions.
18. **Next Steps.** Management will update the PBL operations manual and staff instructions, taking on board IED recommendations.
19. Management will further strengthen quality assurance mechanisms for PBLs and expand its outreach and training programs on various modalities, including PBLs.
20. The proposal to create a crisis-window for concessional assistance-only member countries will be discussed with ADF donors.
21. DEC will review IED disclosure policy, particularly issues of timing, sequencing, submission, and disclosure of IED reports. This issue could be considered as part of the upcoming corporate evaluation policy.
22. **Other Business.** The DEC Chair congratulated a member, Mr. Philip Timothy Rose, and welcomed him again to DEC in his new capacity as Executive Director.