

## EXECUTIVE SUMMARY

Program lending has been the main instrument through which the Asian Development Bank (ADB) has supported policy reforms of developing member countries (DMCs). It was also used extensively in responding to the Asian financial crisis. Between November 1987 when ADB approved a new approach to program lending and the end of 2000, 70 programs and 16 sector development programs (SDPs) were approved. The combined loan amount was \$14.5 billion, 22 percent of ADB's total during that period. This special evaluation study assesses the effectiveness of program lending in promoting policy reforms in the DMCs, and identifies generic measures that could further enhance the effectiveness of program lending.

Program approvals increased in 1996 from around four per year to around 10 per year. In part, this is explained by ADB's response to the Asian financial crisis. In terms of loan amount, crisis loans during 1997-1999 accounted for half the program lending in the whole 13-year period. Program lending has been adapted to changing circumstances. SDPs were introduced to combine sector reforms with project lending; the special program loan modality was brought in to separate crisis from noncrisis lending; the program cluster approach was initiated to provide a longer-term framework for policy reform; technical assistance (TA) loans are now included in some programs. There is a continuing need for policy reforms in DMCs and hence a continuing demand for program lending.

On average, program loans have been larger than project loans (excluding the crisis loans, \$94 million versus \$72 million). Program lending has become more diverse. Although only a few countries account for the bulk of program lending amounts, altogether 27 countries have taken up program or SDP loans, including smaller Pacific DMCs and new DMCs in Central Asia. The bulk of program lending has been concentrated in the agriculture, industry, and financial sectors. However, lending for the industry sector declined in the 1990s while lending for public sector management reform and other sectors increased.

Ratings for programs in project/program performance audit reports (PPARs) are much less diverse than those for projects. Of the 21 programs approved since 1987 that have been evaluated and rated, only one (5 percent) was rated as unsuccessful, three (14 percent) as successful, and 17 (81 percent) as partly successful. For the much larger number of projects evaluated during the same period, 15 percent were rated as unsuccessful, 58 percent as successful, and 27 percent as partly successful. The number of program ratings in the partly successful category suggests there may be generic problems with program preparation and implementation. At the same time, there is also uncertainty in rating programs, where attention must be paid to impacts that are difficult to assess. This makes the evaluation of programs more qualitative.

Total disbursements for 58 programs approved and completed from 1987 to 2000 were only 9 percent below the approved loan amount. However, they took much longer than planned. Whereas disbursements were expected to be completed within an average of 15, and a maximum of 24, months from loan effectiveness, actual disbursement took place over an average of 24, and a maximum of 52 months. The perception of program lending as a quick-disbursing modality does not quite reflect the time it takes to effect policy changes.

Since 1987, nearly all program loans have been designed with two tranches. A delay in second tranche release is the norm rather than the exception. Of second tranches for closed programs, 72 percent were delayed and 11 percent were cancelled altogether. The two-tranche design has focused attention on meeting specific conditions in a program. Greater flexibility in meeting program objectives would be afforded by the use of program loans with different designs, including multiple tranches, floating tranches associated with key events, and single-tranche loans.

Although programs have been ambitious in the policy changes they have sought to effect, containing a large number of conditions within a tight time frame, most program conditions have been met. On average, each program had 38 conditions. The average number of conditions not met or waived has been only about one per program. The ambitious and complex nature of policy changes has been reflected in delays in tranche releases and program completion rather than the proportion of program conditions not finally met.

Project loans have a mechanism for changes in scope during implementation. Depending on the scale of the changes, they can be approved at project director or Management level. Only major changes in scope that fundamentally affect the objectives of the project require the approval of ADB's Board of Directors. The existing mechanism for changes in scope for program loans is highly restrictive and rarely used. In general, any changes require Board approval. The treatment of disbursement in program lending imposes a much higher rigidity on implementation than is the case for project lending.

It is difficult to assess program impact. There have been positive impacts, easiest to assess when programs have supported trade and policy change in the agriculture and industry sectors that produce tradable goods, and for the crisis loans that provided immediate macroeconomic support. For support to nontradable sectors, including the financial and infrastructure sectors and public sector management reform, longer-term impacts are harder to discern. Similarly, the link to poverty and social impacts are not easy to analyze. Concessional lending has softened the terms of external debt for some smaller countries, but the loan size has enhanced indebtedness. Some programs have had a substantial impact on private sector development, but overall the results in this regard have been mixed.

The three programs rated as generally successful were prepared and designed in different ways. However, they share three common characteristics. First, the government took the major role in designing the program measures and in implementing them. Second, the programs were developed at a specific "macroeconomic moment," when macroeconomic vulnerability created not just a need for borrowing but an understanding of the need for reform. Third, delays in meeting specific conditions reflected a more realistic time frame for program implementation, but did not detract from the direction of reform. The only program rated as unsuccessful also contained a major lesson, namely that programs designed around formal rules and conditionalities also need to take account of informal policy reform mechanisms, and of the necessary incentives for those expected to implement the reforms.

Adjustment costs have played a dominant role in determining loan size, though there is no precise means of estimating adjustment costs, that may include the cost of establishing new agencies, retraining and relocating people, revenue losses, funding existing debts, etc. Possible revenues from program reforms such as privatization proceeds, and a government share of the costs of reform, need to be considered when determining the program loan size. On the other

hand, adjustment costs also fall on nongovernment and private commercial agencies that may need temporary assistance in meeting them.

There are a few cases of program loans repeated in the same sector of a country. In some cases, lessons from the earlier intervention were incorporated in the design of the subsequent program, but in others they were not. In addition, there are generic aspects of program lending that should be learned across sectors and ADB departments. The most common is the reference to weaknesses in government commitment and institutional limitations. Across completion reports for programs and PPARs, some lessons to be learned are repeated, suggesting that generic lessons are more difficult to incorporate in subsequent operations across, rather than within, sectors.

DMCs have made significant progress in adopting more market-oriented policies. However, in some cases, formal compliance with conditions has not resulted in sustainable reforms. There have been cases where compliance has been achieved in unexpected ways that have circumvented the original intent (e.g., by rearranging responsibilities between agencies, rather than separating functions from the government and laying off staff). The recurrence of conditionalities between loans and sectors is another indicator that reforms cannot always be sustained. Nevertheless, in several cases, program conditions have been enacted after loan closing and formal program completion, indicating a problem of process and timing rather than unwillingness to enact reform.

A weakness of program lending has been insufficient resources for institutional capacity building during implementation of policy reforms. Programs are more difficult to implement than projects. The effectiveness of TAs associated with program lending has varied. Given the short period for policy changes provided in program design, TA outputs have sometimes come at a late stage of implementation. Stronger capacity building is required, especially in policy analysis during program formulation and in the coordination of implementation. Assistance in these areas needs to be sustained over more than the relatively short period of one program. An overriding issue relates to the ability to make reform popular, for example, through consultations with stakeholders, including those in the private sector, and the participation of civil society. Commitment to reform may depend not just on an appropriate "macroeconomic moment," but on timing in relation to government tenure (i.e., in terms of the electoral cycle) and on the need to maintain social cohesion.

ADB has internal constraints. The program framework and policy matrix used in program preparation provide a logical connection between policy changes, outcomes, and inputs. However, it is difficult to build flexibility into the program framework. Often there are many conditions with no prioritization, and the policy framework is not conducive to the consideration of alternatives, either for program elements or for timing. The incentive system within program lending may favor central agencies over line agencies and other stakeholders. The PPARs show that programs are subject to greater risks than projects. These risks fall on some groups within DMCs but not on others. A greater country focus would facilitate better understanding of borrower constraints, particularly if backed up by high level policy dialogue. Program loans are labor intensive and demanding of specialized skills, which need to be further developed in ADB. A change in focus of economic and sector work from outputs to results would assist in program formulation and implementation.

The key findings of this evaluation have led to the following conclusions. First, program lending had and will continue to have a high level of relevance to the needs of DMCs. There has been a demand for program lending from most DMCs. The program loan modality has proved a highly useful instrument in the context of the Asian financial crisis. Helpful modifications in the modality toward SDPs, special program loans, and the program cluster approach have already been made, but further changes are needed to allow greater flexibility in implementing policy reforms.

Second, program lending has been moderately efficacious. It has supported substantive legislative and policy changes, and a very high proportion of program conditionalities has been met. Nevertheless, the proportion of 86 percent for partly successful and unsuccessful programs is much greater than the proportion of 42 percent for partly successful and unsuccessful projects. The design and implementation of programs can be characterized as attempting to achieve a lot in a limited time frame. There have been significant delays relative to planned disbursements. Programs have not always been firmly based on an assessment of achievable rates of change, and have therefore been too inflexible. Government ownership of the formulation and implementation process is essential for success of reform programs. However, government ownership needs to be complemented by greater participation in program formulation of those that will be affected, directly and indirectly, by the program. Policy reform packages tend to focus on changes in the formal rules of sector operation. There has been insufficient understanding of the informal rules that characterize all economic structures, and insufficient analysis of the incentive structure for those whose behavior has to change.

Third, it is difficult to assess the efficiency of program lending. Despite being more complex and requiring different skills than project lending, approval of programs has been achieved at the same level of resource use. This could be interpreted as formulating and implementing programs with fewer resources than would have been desirable.

Fourth, programs have not always led to sustainable outcomes. Some reforms have not been fully implemented, and a few have been reversed. Support for policy changes needs to be built up through analysis of the costs of not changing, and dissemination of information on the problems that the policy changes are addressing. Greater attention to the distribution of risks in program design and implementation would point to measures that may be necessary to ensure security of incomes during the period of change.

Finally, many of the programs have had a substantial impact on the economy, trade, and prices. In other cases, development impacts have not been clearly identified or monitored. TA has been variable in its impact too. Institutional development and capacity building have generally lagged behind requirements. The overall impact of program lending has been smaller, and less clear, than anticipated.

A number of specific recommendations are made to increase the efficacy, sustainability, and development impact of program lending. First, there are several options for program loan design. Programs should involve multiple tranches where appropriate, and there should be greater flexibility in deciding about the continued relevance and appropriate timing of conditions. Floating tranches could be introduced into some programs, to be released upon implementation of significant legislative or other actions. In other cases, the single-tranche design may be appropriate. In all cases, a justification should be provided for the number of tranches and the program period.

Second, government authorship of the reform package needs to be complemented by participation of affected groups and sectors in program formulation. The costs of not reforming should be analyzed and publicized along with the benefits of the program, through extensive publicity drives to disseminate information relating to proposed policy changes.

Third, program lending supports policy changes that are expected to have a sector- or economy-wide impact. If properly designed and implemented, the beneficial effects will be far greater than any direct costs of program measures and adjustment costs. Successful design and implementation of programs require specialist skills of analysis and coordination. DMC governments should use a significant amount from the counterpart funds from program loans for building their capacity for designing and implementing programs.

Fourth, program design and implementation should be assessed internally by a small peer review group. Staff consultants, particularly consultants from the Asian and Pacific region with direct experience of implementing sector reform programs, could be involved in the peer review process.

Fifth, provision for limited forms of change in scope and implementation arrangements of programs through Management approval would provide greater flexibility in implementation. A proposal should be formulated for Board consideration to delegate the authority for approving such changes to Management.

Sixth, improvements are required in the way in which programs are evaluated. The Operations Evaluation Department should (i) undertake reevaluation studies of three selected programs to better assess the sustainability of program reforms; (ii) update guidelines specifically for the evaluation of programs, including the evaluation of impacts in light of current strategic concerns; and (iii) undertake evaluation of selected programs during implementation.