

ASIAN DEVELOPMENT BANK

REVIEW OF THE BANK'S PROGRAM-LENDING POLICIES

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I. INTRODUCTION

1. The Bank first introduced a program lending instrument in 1978, to finance the importation of essential production inputs in situations of foreign currency shortage.¹ The program lending policy was slightly revised and its scope widened in 1983.² A more fundamental revision took place in 1987, shifting attention from the financing of inputs to sector policy reforms.³ From November 1987 through December 1995, 34 sector/subsector programs were approved under the revised policy, for a total lending volume of \$3.7 billion. An initial review of the new lending modality was carried out in 1990.⁴ A comprehensive review of the Bank's program lending policies is called for under the "Action Plan for Effective Operation" adopted in connection with the Bank's Fourth General Capital Increase (GCI IV).

2. While policy-based program and adjustment lending has played an important role in supporting economic reform in many developing countries over the last 10-15 years, the general policy environment in many of the Bank's developing member countries (DMCs) has now considerably improved, with generally sounder macroeconomic and sectoral policy frameworks, improved external and internal balance, and fewer market distortions. The improvement in the DMC policy environment is reflected in their increased access to external commercial sources of capital. At the same time, the need for policy reform in many DMCs and sectors remains strong, especially in economies shifting from a centrally planned or heavily interventionist to a more market-oriented development model. A large number of DMCs are, thus, still undergoing adjustment programs supported by the International Monetary Fund (IMF). Furthermore, policy support has become an important operational objective of the Bank. The latest Medium-Term Strategic Framework (MTSF) of the Bank has identified policy support, capacity building, investment financing, and regional cooperation as key medium-term operating objectives of the Bank.⁵ The Bank's ability to promote and encourage policy reform is a key distinctive feature and comparative strength vis-à-vis commercial sources of funds, and program lending is an important operational instrument of the Bank for promoting policy reform. These developments call for a thorough assessment of the performance and effectiveness of program lending in the past, and of its continued relevance for the Bank's DMCs in the present environment.

3. This Paper provides an overview of the evolution of Bank policies with regard to program lending, program lending operations carried out so far, and typical reform agendas supported by Bank program loans (Chapter II). Policy-based lending of other multilateral institutions is briefly presented in Appendix 1. A performance assessment of program lending is provided in Chapter III, reviewing the quality of program design, the implementation experience with policy conditionalities, the contribution of program loans to the reform process, and the impact of the programs on underlying sector objectives. In light of the foregoing, a combination of investment and policy lending, with a view to meeting sector needs in a more integrated fashion, is recommended in Chapter IV; criteria for use of the various assistance modalities under different conditions are proposed in Chapter IV; and a number of practical suggestions for strengthening the design, processing, and administration procedures for program loans are formulated in Chapter IV.

¹ Doc. R10-78, Revision 1, Final, *Program Lending*, dated 24 February 1978.

² Doc. R21-83, Revision 1, Final, *A Review of Program Lending Policies*, dated 10 March 1983

³ Doc. R117-87, Revision 1, Final, *A Review of Program Lending Policies*, dated 5 November 1987.

⁴ Doc. WP2-90, *A Review of the Bank's Program Lending Policy*, dated 1 March 1990.

⁵ See MTSF documents (1992-1995), (1993-1996), (1994-1997), and (1995-1998).

II. OVERVIEW OF PROGRAM LENDING SINCE INCEPTION

A. Background

4. Policy-based adjustment lending by the World Bank was developed in the early 1980s¹ as an instrument to deal with the debt crisis affecting many developing countries (especially in Latin America and sub-Saharan Africa) at the time. The debt crisis was primarily the result of unsound macroeconomic and microeconomic policies pursued over the preceding decade, exacerbated by an unfavorable external environment in the early 1980s. The debt crisis called for immediate balance-of-payments (BOP) support to maintain basic output and consumption. At the same time, macroeconomic and structural policies in many countries underwent drastic adjustment, including adoption of tighter fiscal and monetary policies, exchange rate devaluation, and a general shift from inward-looking and interventionist policy regimes towards more market-friendly, outward-oriented ones. After supporting economywide stabilization and adjustment programs, the World Bank began to shift attention to sectoral adjustment plans in the mid-1980s.

5. The Bank initiated program lending in 1978. In contrast to project lending, which supports capital investments, program loans provided financing for the importation of production inputs, to permit fuller capacity utilization in priority sectors of the economy in a climate of foreign exchange constraint. The policy was first amended in 1983, when modernization and rationalization of production facilities were added to the capacity utilization objective. The 1983 policy revision also envisaged enhanced policy dialogue with country authorities on medium-term sector development plans and policies, and increased use of technical assistance (TA) to analyze sector issues and strengthen institutions. Eight program loans totaling close to \$500 million were approved under the new facility from 1983 until late 1987 (against \$88 million provided prior to the 1983 policy revision). Program lending accounted for 5.5 percent of total Bank lending during that period, compared with the 7.5 percent annual ceiling set in 1983. Program loans were exclusively targeted at the agriculture sector, and financed fertilizer and other inputs needed for crop intensification. Although concern for policies was there, policy reform was not considered an essential prerequisite for program lending prior to 1987. Accordingly, while the overall direction of desired policy changes was generally indicated, no explicit action plan for their implementation was usually laid down. As a result, program loans were not successful in accomplishing their longer term policy objectives, even though they generally achieved the goal of short-term production support. The need for an instrument better adapted to addressing underlying sector constraints in a systematic manner led to the extensive revision of the Bank's program lending policies in 1987.

B. Existing Policy Framework

6. The present program lending policy of the Bank, adopted in 1987, corresponds closely to the World Bank's sectoral adjustment loan (SECAL) instrument.² The 1987 policy revision fundamentally shifted the focus of program lending, by deemphasizing the provision of

¹ Earlier International Monetary Fund standby credits, which provided liquidity support to countries with balance-of-payments difficulties undertaking macroeconomic stabilization programs, can be regarded as precursors of the World Bank adjustment and Bank program loans that evolved in the 1980s.

² There are, however, some operational differences between the two types of instruments. For example, unlike SECALs, the Bank's program loans are not linked to BOP considerations.

import finance and focusing on sector policies and medium-term development plans instead. The objective of program loans was defined as addressing underlying sector needs and constraints, including policy reform, institutional strengthening, and investment plans, in a focused and integrated manner. Program formulation was to be based on detailed and comprehensive sector analysis, and on extensive policy dialogue with country authorities to ensure that the proposed reforms enjoy fully government support and are practically feasible. In order to enable wider and more effective use of the program lending instrument, some of the constraining features in the previous policy were removed. Thus, the requirement for BOP justification was abolished,¹ i.e., the rationale for program lending was shifted from capacity underutilization in a sector on account of foreign currency shortage, to soundness of the proposed sector policy reform and development plans; the overall 7.5 percent ceiling on program lending was raised to 15 percent, and the 20 percent ceiling for individual countries was abolished; and procurement guidelines were liberalized to facilitate quick disbursement. In view of the considerable need and scope for policy reform in many DMCs, it was also envisaged that program lending would apply to a wider range of sectors than in the past, including, *inter alia*, industry, energy, transport, and the social sectors. The main features of the Bank's current program lending policy are summarized in Appendix 2.²

7. During the Board discussion of the 1987 policy revision, donor countries generally expressed support for the linkage of Bank assistance with the adoption of efficiency-enhancing, market-oriented policy reforms in the DMCs. Some members, however, expressed concern with regard to the policy analysis capabilities of the Bank (which was viewed primarily as a "projects bank" at the time); the ability to monitor the implementation of agreed upon reform programs; and the ability to evaluate their impact. All members stressed the importance of sector analysis prior to the formulation of program loans, of intensive and continuous policy dialogue with DMC authorities, and of close coordination with IMF and World Bank. As regards the division of tasks among the multilateral development banks (MDBs), it was agreed that the Bank would not become involved in purely macroeconomic issues, and would generally focus on sectoral policy reforms. Some of these, however, have broad economywide implications, and the interface between sector and macroeconomic considerations would have to be addressed in Bank program loans.

8. Borrowing countries generally appreciated the quick-disbursing character of program loans, as well as the greater flexibility in the utilization of funds that they afforded. Some DMC governments, however, expressed concern with regard to possible attempts by MDBs to impose undesired policies on them. MDB involvement in policy formulation was perceived as a potential infringement of the sovereign right of countries to determine their own development policies. To alleviate these concerns, it was agreed that policy dialogue should be

¹ In practice, it was impossible to determine that any prevailing BOP constraint had, through the reduction in required sector inputs, constrained sector output below optimum levels.

² The Bank's policies also contain provisions for "emergency rehabilitation" and "technical assistance program loans." The former assist small island DMCs affected by natural disasters to rehabilitate essential infrastructure and production facilities. The latter comprise a series of project preparatory TAs to prepare feasibility studies and/or detailed engineering for a number of projects. These two types of instruments do not seek to address sectoral policy issues, but merely relate to a "program" in the sense of a group or series of activities. As such, they have little in common with the policy-based program lending instrument examined here and are, therefore, excluded from the analysis.

approached with caution on part of the Bank, and should be a genuine two-way exchange of views. At the same time, the Bank would link its assistance to the institution of reforms it considered essential for achieving efficient and sustainable growth.

9. An initial review of the new program lending policy was carried out in 1990. While limited experience with regard to the implementation of program loans, and *a fortiori* their impact on sector performance, was available at the time, the preliminary assessment of the new policy was positive. Program lending had enabled Bank operations to acquire a wider dimension than would have been possible through project lending alone, and had contributed to the redirection in policies that was a key factor behind the successful performance of many Asian economies. The review further underscored the importance of sector analysis as a preparatory step for program formulation, and emphasized the contribution that the Bank could make to policy formulation through sector- and issues-oriented studies and related policy dialogue. It also advocated a flexible and pragmatic approach in such areas as dedication of counterpart funds,¹ procurement and disbursement, and postevaluation. The conclusions of the 1990 review of program lending policies remain for the most part fully valid today; as such, the present Paper should be read in conjunction with the 1990 review, whose analysis and conclusions it supplements. The main modifications proposed herein are those relating to the closer integration of investment and policy-based lending (Chapter IV); to more selective and targeted use of the program-lending facility (Chapter IV); and to various processing and administrative procedures (Chapter V).

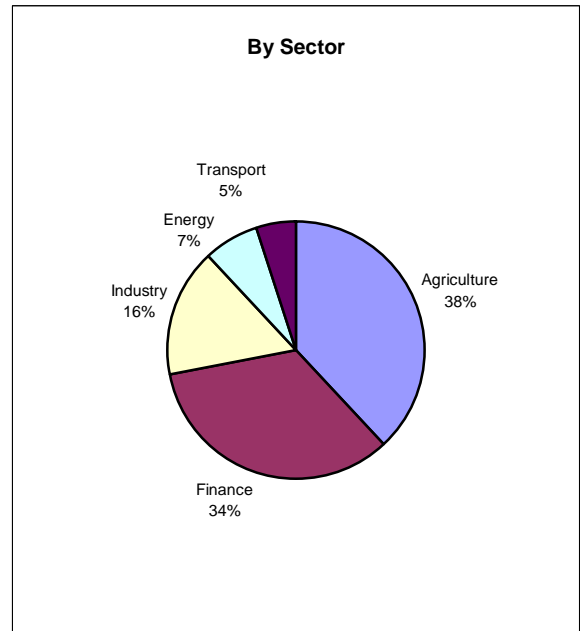
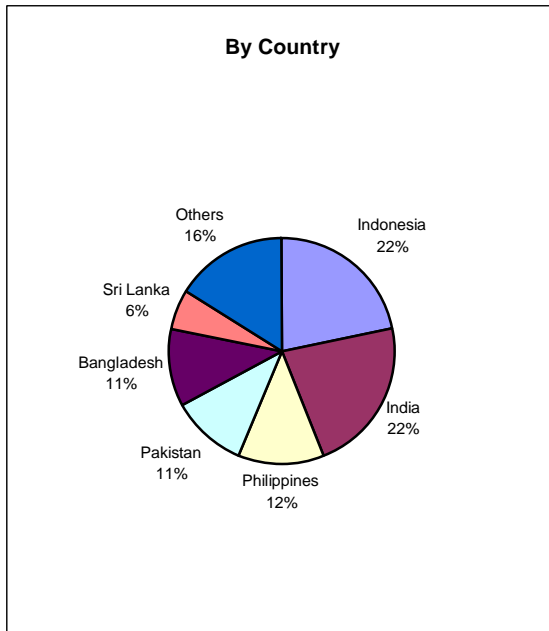
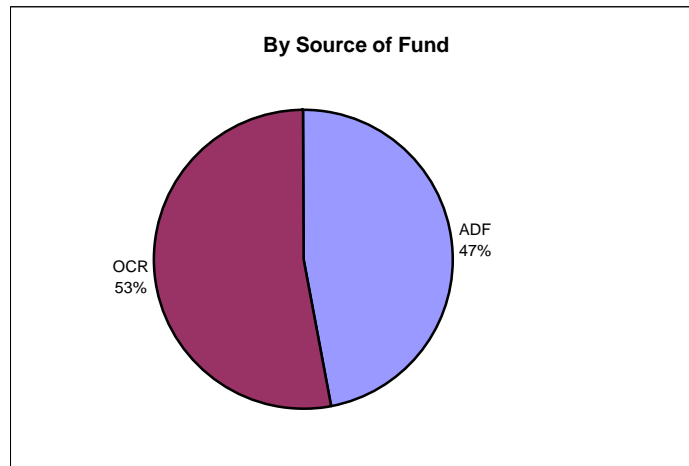
10. While generally endorsing the findings of the 1990 program lending review, Board discussions expressed concern with regard to four main sets of issues: (i) determination of loan amount, (ii) difficulty in quantifying costs and benefits of program loans, (iii) impact on external indebtedness of the borrowing country, and (iv) social impact of program loans. There are no objective determinants for setting the size of a program loan. The main factors taken into account are the size of the borrowing country (in terms of population and gross domestic product), the overall Bank lending program in the country, the importance of the sector, and the strength of the reform package. The loan amount is determined based on these considerations. Related to the lack of objective criteria for determining the size of program loans are concerns with regard to their economic benefits and financial impact. Since program loans create no tangible assets, and costs and benefits are difficult to quantify or conclusively attribute to the loan (see para. 34), program lending cannot be subjected to conventional cost-benefit and rate-of-return analyses. Finally, concerns about the social cost of reforms were expressed, following widespread criticism of the adverse impact on the poor of some IMF- and World Bank-supported adjustment programs (see Appendix 1). In response to the latter concern, a special study on the impact of program loans on the poor was carried out under a Bank regional TA.² The study has been completed, and its findings were reported to the Board (see paras. 39-40);³ the main recommendations have been incorporated in Bank policy guidelines.

¹ Counterpart funds are the local currency funds accruing to the borrowing government under a program loan.

² Doc. R183-92, *Technical Assistance for Study of Framework for Assessing Social Impact of Program Loans*, dated 16 November 1992.

³ Board Information Paper, TA No. 5508-REG: *A Study of a Framework for Assessing the Social Impact of Program Lending*, dated January 1995.

**Figure 1: Program Lending by Source, Country, and Sector
(by volume, November 1987-December 1995)**



C. Program Lending Since 1987

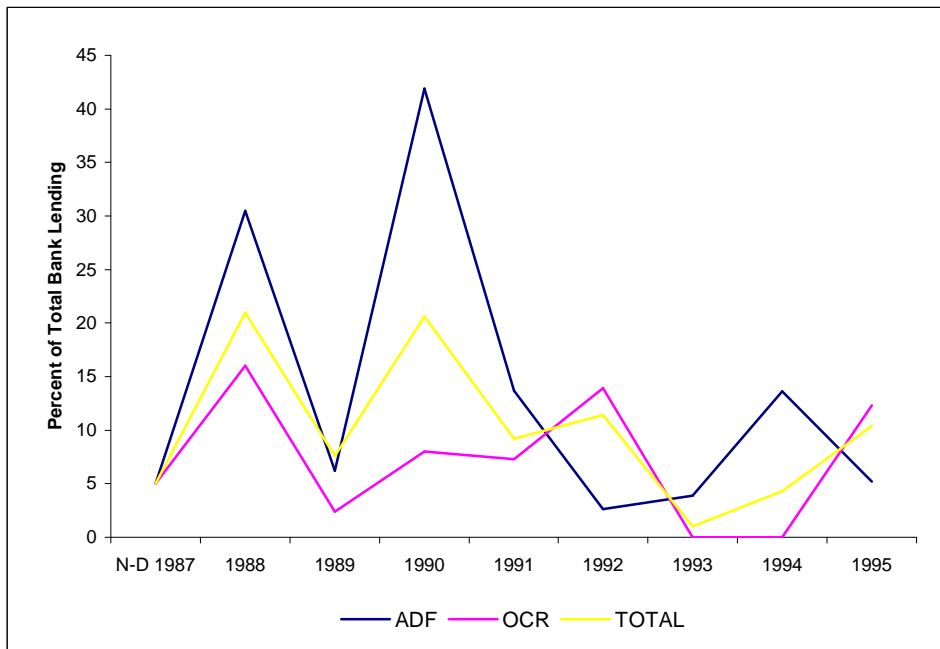
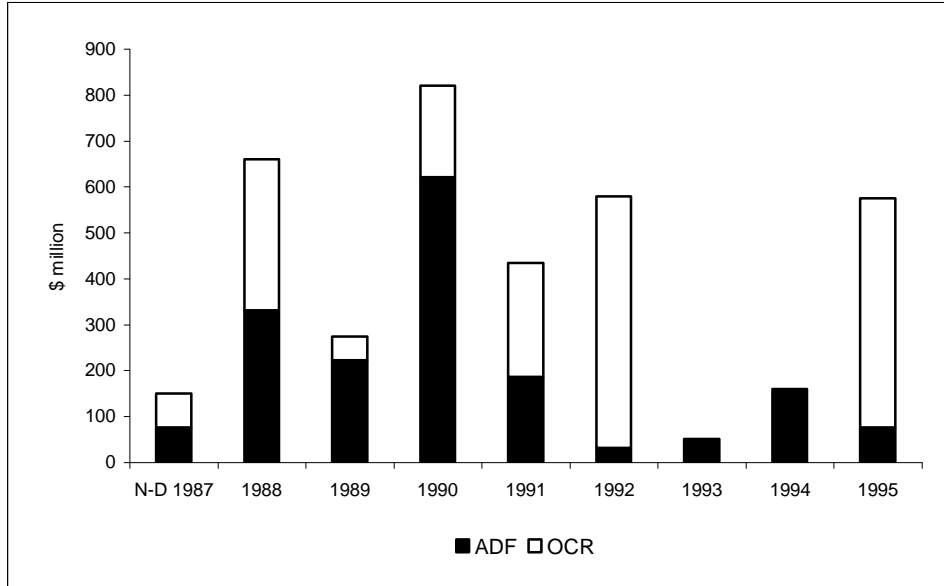
11. The revised policy framework was adopted in November 1987. From that time until 31 December 1995, the Bank had approved 42 program loans for 34 sector or subsector programs. Eight programs to ordinary capital resources (OCR)/Asian Development Fund (ADF) blend countries were supported by a combination of OCR and ADF loans. Total program lending volume amounted to \$3,706 million, of which 53 percent was from OCR and 47 percent from ADF resources. On average, program lending accounted for 9 percent of total OCR lending, 15 percent of ADF, and 11 percent of overall Bank lending during 1988-1995. The limitations imposed on program lending, i.e., 15 percent of total and 22.5 percent of ADF lending, were thus respected.¹

12. Over half of all programs, accounting for nearly 40 percent of lending volume, were in the agriculture sector. Some of these related to specific subsectors, such as forestry or fisheries. The remaining programs concerned mainly the finance (seven) and industry (six) sectors. Three programs related to subsectors of the transport (road, railways) and energy (hydrocarbons) sectors. The main recipient countries were Indonesia and India, followed by Philippines, Pakistan, and Bangladesh. Together, these five countries account for nearly 80 percent of program lending volume. A list of program loans approved since November 1987 is shown in Appendix 3. Salient features of program lending since 1987 are presented in Appendix 4 and summarized in Figures 1 and 2.

13. Substantial TA has been provided in connection with program loans, reflecting the strong emphasis on institutional strengthening and policy analysis to address underlying sector constraints. Overall, 66 TAs for a total of \$28.9 million were attached to program loans, in addition to a large number of TAs indirectly related to the policy and institutional issues addressed in program loans. Six programs involved cofinancing, primarily from official sources. In one instance, the 1988 Financial Sector Program in Indonesia, cofinancing was raised from commercial sources under the Bank's Complementary Financing Scheme, with additional comfort against sovereign risk provided by a partial Bank guarantee of the later maturities. The total volume of cofinancing for program loans amounts to \$565 million. While appreciable, this only partially reflects the resource mobilization impact of program loans in terms of providing an improved policy and institutional environment for official lending as well as for private investment in a sector.

¹ The program lending ceilings are interpreted in terms of the three-year moving averages centered on the current year.

Figure 2: Program Lending by Year



14. The number and volume of program loans increased markedly following the 1987 policy revision. From 1988 to 1992, the average volume of program lending per annum was \$550 million. A slowdown was experienced in 1993 and 1994, partly reflecting a decline in the demand for program loans as some of the major borrowing countries substantially completed their overall adjustment program and restored macroeconomic balance (although the need for policy reform in specific areas remains strong). The slowdown also reflects to some extent shortfalls and delays in the implementation of ongoing program loans. In 1995, however, program lending recovered to \$575 million because of new demands from the transitional economies as well as the broadening of sectoral scope to encompass capital market development, an area of critical importance for increasing domestic and external resource mobilization and improving the efficiency of resource use in many DMCs.

15. Disbursement experience with program loans has generally been satisfactory, following simplifications adopted under the 1987 policy. The latter detached procurement and disbursement from the project-related procedures earlier prevailing, e.g., by widening the range of eligible imports and beneficiaries, and by adopting more liberal procurement guidelines. This has facilitated rapid disbursement of program loan funds. Average cumulative disbursements at the end of the first year thus exceeded 50 percent of loan amount, and 75 percent at the end of the third year. Delays were, however, common in second tranche releases, because of delays in the meeting of covenanted policy conditions (see para. 23).

D. Reform Agenda

16. Reform agendas supported by Bank program loans generally seek to shift a sector or subsector from a statist, inward-looking development model to a more market-friendly and outward-oriented one. Policy measures supported generally relate to two principal areas:

- (i) **The Incentive Structure for Private Sector Growth:** This comprises two main components, viz., adjustments in relative prices and deregulation. Prices are realigned to reflect economic values, i.e., opportunity costs and/or border prices, by lowering trade barriers, eliminating subsidies, and removing price controls. Sector deregulation, i.e., liberalization of the regulatory framework in a sector, typically addresses issues such as investment and capacity licensing, scope for private sector participation, foreign investment regime, and miscellaneous barriers to entry and exit.
- (ii) **Government Finances and Administration:** This typically encompasses reduction of the public sector deficit through tax reform, rationalization of subsidies, and restructuring and/or privatization of public enterprises. In addition to the consolidation of public finances, the objective is to redefine the role of the state in the economy, with emphasis on the provision of basic social and economic infrastructure and services (especially where public goods or externalities are involved) and a sound institutional and regulatory framework for growth, rather than direct intervention in the production and distribution of goods and services.

17. In sum, macroeconomic as well as sectoral reforms seek to improve the amount and efficiency of investment in an economy or sector through three interrelated efforts: (i) enhancing resource mobilization by increasing cost recovery of utilities and state-owned

enterprises (SOEs), eliminating or reducing subsidies, and raising real interest rates: (ii) improving the allocation of resources through adjustments in relative prices, lowering of trade barriers, limitation of directed credit, and rationalization of public investment; and (iii) promoting efficient resource use through increased domestic and external competition and a greater role for the private sector. Specific reform agendas in the main sectors supported by Bank program loans, i.e., agriculture, industry, and finance, are further described in Appendix 5.

III. PERFORMANCE ASSESSMENT

18. Performance assessment of program lending involves four main questions: (i) Have the reform programs been well designed? (ii) Have the reforms been successfully implemented, i.e., agreed upon at loan approval and laid out in the Development Policy Letter? (iii) Has the financial support provided by program loans played an important role in encouraging and facilitating the reform process? (iv) Have program loans had the desired impact on underlying sector objectives? Based on an analysis of these four sets of issues, an overall assessment of the effectiveness of program lending is attempted in this chapter.

A. Program Design

19. Questions with regard to the quality of program design refer essentially to the adequacy and pertinence of the relevant policy prescriptions. By and large, these are based on the application of market principles for achieving greater efficiency in resource allocation and use. A remarkable degree of consensus (though not unanimity) now exists worldwide with respect to the relevant market-based, outward-looking development model. The successful economic performance of many DMCs in the region can to a large extent be attributed to the adoption of market-oriented economic policies, together with a sound macroeconomic framework, high savings rates, investment in human development, and efforts to achieve an equitable distribution of the benefits of growth. Furthermore, the detailed content of all program loans is the result of extensive discussion between the Bank and the borrowing government, and generally represents the best possible compromise between mutually agreed objectives and practical constraints at the time of loan approval. Assessment of the quality of program design is, therefore, based primarily on the findings of the 8 program performance audit reports (PPARs) and 13 program completion reports (PCRs) of program loans carried out to date.

20. Some of the earlier program loans approved after adoption of the 1987 policy have been criticized during postevaluation as suffering from insufficient preparatory sector analysis and policy dialogue, with resultant deficiencies in program design. For example, the 1988 Agriculture Program Loan in Nepal¹ focused on the fertilizer subsector only, and did not include comprehensive reforms with respect to that subsector; was not based on exhaustive subsector analysis (a TA for a fertilizer subsector management study was approved subsequently to the loan); contained some internal contradictions (e.g., promoting private sector participation in fertilizer distribution while at the same time attempting to strengthen the state-owned Agriculture Inputs Corporation); failed to express policy reforms in time-bound and monitorable terms; and provided little additionality to an ongoing World Bank SAL. The PPAR

¹ Doc.N.157-93, *Project Performance Audit Report, Agriculture Program Loan (Nepal)*, dated 24 August 1993.

for the first Bangladesh Industrial Program Loan¹ also notes that the latter did not assign sufficient staff resources for program preparation or supervision; did not include adequate consultations with government policymakers; and was not based on a clear industry sector strategy including specific and quantified targets. However, these design weaknesses can, to a large extent, be attributed to the learning curve process, and were corrected in later program loans. For instance, comprehensive sector analysis prior to program formulation, extensive policy dialogue with government authorities, and systematic loan tranching with specific and objectively monitorable conditionalities are now standard features in Bank program loans. Because of the PPARs and PCRs presently available relate mainly to early post-1987 program loans, it is recommended to undertake a more comprehensive assessment of the program lending instrument once a larger proportion of the new program loans have been postevaluated.

21. A gradual approach to policy reform was adopted in many cases. A number of programs thus sought to reduce, rather than eliminate, major sector distortions.² There also appears to be, at times, a tendency to defer decisions on sensitive matters, by providing for studies in the program and requiring the government to review and/or adopt at a later stage the ensuing recommendations.³ A cautious and gradual approach to reform may well be appropriate in many cases, given the difficulties associated with implementing far-reaching reforms that often involve sensitive social and political issues. Under such circumstances, however, the program lending approach can be justified only in the perspective of a long-term, continuous plan of sector adjustment, of which the loan in question finances a time-slice. This is in fact envisaged by the Bank's program lending policies, which foresee Bank support for a succession of reform packages in a sector, each building on and extending the achievements of its predecessor. Under such conditions, it may be useful to place each individual program loan more explicitly in the relevant long-term perspective.

22. Bank support for a gradual reform process, adapted to individual country and sector circumstances, indicates that the design and content of program loans were generally the result of a genuine exchange of views and dialogue between the borrower and the Bank, rather than standard solutions being imposed from outside irrespective of their suitability and feasibility. At the same time, the selection of recipient countries (see para. 12) shows that program loan assistance has been carefully targeted at genuine reforms, i.e., at governments of DMCs such as Indonesia and India that have moved decisively to restore macroeconomic balance, eliminate market distortions, and reduce state control over economic activity.

¹ Doc.IN.148-92, *Project Performance Audit Report, Industrial Program (Bangladesh)*, dated 4 August 1992.

² For example, the Nepal Agriculture Program did not seek to address all market distortions with respect to agricultural inputs and outputs, but merely attempted to raise fertilizer prices to levels at or above those prevailing in India (to prevent illegal cross-border diversion). The Industrial Sector Program in Pakistan sought to raise the investment threshold for government approval from PRs700 million to PRs1 billion, rather than abolish all investment licensing, and aimed to reduce the maximum import tariff from 125 percent to a still restrictive 100 percent.

³ For example, the Road and Road Transport Sector Program in the Philippines limited requirements with respect to price liberalization, road safety standards, and vehicle emission controls to the completion of relevant studies, and the formulation of long-term plans and strategies in accordance.

B. Implementation of Reforms

23. A fairly large number of policy conditions included in program loans incurred implementation delays vis-à-vis the originally envisaged schedule. Second tranche release was delayed in two thirds of cases where target dates had been set, by an average period of about one year. In two instances, the second tranche was canceled on request of the borrowing government.¹ The frequency of program implementation delays parallels the World Bank's experience in adjustment lending, which notes an average implementation period of 838 days for a typical reform measure, against the maximum one and a half years (548 days) normally expected at appraisal.²

24. Implementation difficulties concerned particularly measures involving the restructuring or privatization of SOEs, which generally involves retrenchment of surplus labor. Problems also tended to occur with other politically sensitive measures, such as raising the prices of essential commodities or increasing taxes. Sometimes, delays arose where adoption of reforms required close coordination among several government agencies, or was contingent on approval by a country's legislature. To a certain extent, the frequency of delays may reflect inadequate appreciation of the social and political setting in the DMC concerned, and of the difficulties involved in implementing far-reaching reforms typically involving negative as well as positive impacts. However, implementation shortfalls, especially delays in the release of second tranches, also tend to indicate that reform measures included in program loans were generally significant and substantive, and that the Bank has applied strict standards for determining compliance.

25. Despite the delays encountered, Bank (as well as World Bank) experience shows that most reform measures are, eventually, implemented. Based on the results from PPARs and PCRs available to date, an average of 62 percent of all policy conditionalities were fully complied with at the end of the program period, while another 15 percent were substantially and 16 percent partially complied with. Only 7 percent of policy conditions had, thus, not been met. While the policy conditions not or only partially met include some of the more difficult reforms, such as worker layoffs or elimination of subsidies, many difficult and substantive reforms have been successfully implemented. Also, progress has been achieved even where fully and timely compliance with policy covenants was not possible, including in some cases after the end of the program period as part of an ongoing adjustment process. Nevertheless, a key lesson emerging from the implementation difficulties encountered is that strong government commitment to reform, including the political will to adopt unpopular measures where necessary, is essential to the success of the reform program. In some cases, where strong opposition from affected groups is likely, front-loading of the more difficult reform measures may be necessary to ensure satisfactory implementation of the program. At the same time, in view of the dislocations caused by drastic policy change, and the sometimes adverse short-term impact on specific groups, an

¹ In the Second Industrial Program Loan in Bangladesh, a request for cancellation was made in recognition of the difficulties involved in implementing agreed upon reforms. In the Nepal Forestry Program, in which counterpart funds were dedicated to various reforestation activities, a revision in the scope of the latter led to reduced public investment requirements; since these could be met from the counterpart funds generated by the first tranche of the program loan, the second tranche was canceled as part of an overall country portfolio restructuring.

² World Bank Report No. 10870, *World Bank Structural and Sectoral Adjustment Operations: The Second OED Overview*, dated 30 June 1992.

incremental pace of reform may often be necessary; the Bank must, therefore, be able to support a gradualist approach to reform as and when suited to specific country and sector circumstances.

C. Need for Program Loans

26. Program lending has made a substantial contribution to the successful implementation of the reform programs supported by the Bank, because the resources provided under program loans were often instrumental in enabling the recipient government to carry out the reforms in an orderly and sustainable manner. In many cases, the borrowing country faced severe macroeconomic imbalances, and urgent support was required for the overall adjustment efforts. In other cases, the sector reform programs themselves required substantial resources to address a deterioration in the financial position of the government or an increase in the national investment-savings gap. In addition, the Bank played an important advisory role in all program loans, bringing its broad cross-country experience and multidisciplinary expertise to bear on the design and formulation of reform programs.

27. Many of the Bank's program loans were provided to countries facing BOP difficulties, and effectively formed part of overall adjustment programs formulated in response to such difficulties. Under circumstances of macroeconomic distress, quick-disbursing, untied assistance is essential to enable a government to carry out structural reform in an orderly and sustainable manner. Furthermore, macroeconomic imbalances must generally be addressed first, because the success of any sector reform program is predicated on a sound macroeconomic environment including low inflation, a competitive and stable exchange rate, and reliable access to imported inputs. Macroeconomic difficulties also tend to shorten time horizons, deflecting attention from the need for underlying structural reforms, which generally yield benefits only over the medium to long term. Program lending under such circumstances provides critically needed BOP support, while complementing and extending economywide reforms introduced under IMF and World Bank programs in key sectors of the economy, such as agriculture or finance.

28. In some cases, such as the transitional economies of Central Asia, macroeconomic difficulties have also taken the form of acute budgetary shortfalls. Where fiscal difficulties are severe, impeding the ability of the government to fund essential public services and operations and maintenance expenditures, program lending can be useful to support recurrent government spending and thereby help create a stable environment within which medium-term structural reforms can be pursued. At the same time, Bank program loans promote the adoption of essential market-oriented reforms in key sectors of the economy, thereby complementing other ongoing reforms and laying the basis for future investment operations in those sectors.

29. Thus, the need for program lending was often identified at a consultative group or aid consortium meeting, that established the emergency financing needs of the DMC in question, the structural adjustment program needed to shift the economy to a sustainable growth path, and an appropriate sharing of the exceptional financing requirements among major external agencies including the Bank. The Bank's program loans typically focused on sectors or subsectors that were complementary to the overall IMF/World Bank-supported adjustment

program, and where the government was willing and able to undertake substantive reforms.¹ Program loans provided under such circumstances responded to a critical DMC need that could not be met from commercial sources, and were the expression of close cooperation and burden-sharing among international financial institutions. Typically, the stabilization programs adopted under such circumstances helped restore internal and external balance, while structural reforms at both the macroeconomic and sectoral level enhanced efficiency and raised medium-term growth prospects. Quick-disbursing, policy-based assistance by MDBs alleviates foreign currency and budgetary constraints, and thereby helps maintain basic output and consumption while the government undertakes needed reforms. MDB assistance also plays a key role in restoring international and domestic business confidence, thereby attracting private capital inflows and encouraging investment.

30. In other cases, reform programs supported by program loans involved significant short- or medium-term costs — such as loss of government revenue through tariff reductions, injection of public funds to restructure SOEs, or need for compensatory measures to mitigate adverse social impacts. Under such conditions, the general budgetary support provided by a program loan (in the form of counterpart funds accruing to the borrowing government) can help the government undertake the proposed reforms by partly defraying the associated costs. This is especially relevant in countries facing large fiscal deficits, and where the revenue-generating capacity of the government is seriously constrained. Industrial sector programs supported by the Bank often involved substantial short-term costs, because the restructuring of SOEs typically requires large up-front infusions of funds to clear accumulated liabilities (e.g., convert payment arrears into long-term loans or debt into equity) and compensate redundant labor. Tariff reductions also often entail loss of revenue (although the conversion of nontariff barriers into tariffs, and the rise in imports following trade liberalization, tend to enhance revenues). Similarly, financial sector programs often involve significant budgetary costs, for example if government borrowing costs increase or if the adoption of prudential accounting, provisioning, and capital adequacy standards leads to large-scale recapitalization requirements for state-owned financial institutions. The Bangladesh Railway Recovery Program can be cited as example of a program that involved substantial short-term costs, mainly in the form of redundancy payments to retrenched workers, which the program assistance directly helped to meet.

31. Apart from direct fiscal impacts, economic reform generally involved transitional costs, in the form of real output losses as a result of the reallocation of resources, and distributional effects of the realignment of relative prices and shifts in government spending. Program lending can be useful to smooth these transitional costs. In particular, program loans can enable the government to provide mitigative measures to compensate losers of reform, such as consumers paying higher prices for essential goods, producers suffering from loss of protection, or workers losing their jobs. Such compensation, in addition to addressing equity and poverty concerns, can also be important for the political acceptability of the reform program.

32. Many sector reform programs, although not directly associated with short-term costs, also lead to a medium-term rise in the investment-savings gap, as improved conditions

¹ The special assistance loans provided to Kazakhstan, the Kyrgyz Republic, and Mongolia could also be considered as a variety of such program loans. Although they contained no Bank-specific sector policy reforms, they effectively supported overall IMF/World Bank adjustment programs by helping alleviate severe fiscal and/or foreign exchange constraints.

and incentives for private sector activity stimulate investment. A rising investment-savings gap translates into a widening current account deficit; where a country has limited access to the international capital market, especially sovereign borrowings, program lending support may be useful to encourage the government to undertake the needed reforms. This applies for example to capital market development programs, which generally have a more pronounced and immediate impact on national investment than savings. But it is also relevant for most programs in the productive sectors, e.g., agriculture or industrial programs, which stimulate investment while the impact on savings depends on program-specific characteristics, such as the extent to which subsidies or losses of state enterprises are reduced. Program lending can be useful to support such sector reform programs.

33. Finally, a number of program loans played a useful role in enhancing the political acceptability of reforms that would otherwise have been resisted by various interest groups. Where reforms face strong opposition by affected groups, the presence and support of multilateral agencies, which are recognized as objective and impartial partners, can be an important factor in helping overcome domestic resistance to reform.

D. Impact of Program Loans

34. Attempts to evaluate the impact of individual program loans, i.e., their effectiveness in furthering the achievement of underlying sector objectives, are rendered difficult by three methodological difficulties: (i) Bank-supported sectoral reforms generally form part of an overall package of macroeconomic and microeconomic reforms, whose impact is difficult to isolate;¹ (ii) in addition to government policies, a variety of exogenous factors influence sector performance; and (iii) adoption of reform measures cannot be directly and conclusively attributed to the Bank's loan. In view of these difficulties, program loans (as well as IMF and World Bank adjustment loans) are not subjected to conventional cost-benefit analyses and rate-of-return calculations. Nevertheless, this review considers all available evidence with regard to the impact of program loans, including where relevant subjective assessments. It also draws on the extensive review and evaluation of adjustment lending carried out by the World Bank (see Appendix 1).²

35. Of the eight post-1987 program loans postevaluated to date, two were judged generally successful and four partly successful in achieving underlying program objectives. In two cases, performance evaluation was deferred until further data become available. In view of the methodological difficulties in assessing the impact of program loans, these judgments are based partly on the production impact of the inputs supplied under the programs as well as on the fulfillment of the covenanted policy reforms and their impact on sector performance. Because of the long time lags involved, performance evaluation results on a broad cross-section of post-1987 program loans will not become available for another 2-3 years. It is recommended that a systematic analysis of the program lending instrument be undertaken by the Post-

¹ Typically, the influence of macroeconomic parameters, such as exchange rate or inflation, on sector performance is as great as or greater than that of specific sector policies addressed under Bank programs.

² The World Bank has attempted to evaluate the overall impact of adjustment lending by classifying developing countries into broad groups based on the intensity of their adjustment efforts, and comparing their relative performance in terms of a variety of indicators. Owing to their sectoral focus, however, this methodology cannot be applied to Bank program loans.

Evaluation Office at that time, to derive generic lessons with respect to the design and impact of program loans.

36. The Bangladesh Foodcrops Development Program can be cited as example of a program loan that is generally regarded as well designed and that was effective in removing key sector distortions and constraints. The program eliminated government monopolies over the distribution of key agricultural equipment and inputs, reduced input subsidies, streamlined public sector institutions, enhanced producer price support, and rationalized foodgrain pricing and management. Successful implementation of the program (despite some delays) is widely credited with contributing to the accelerated growth in foodgrain output in the early 1990s, which helped Bangladesh nearly attain the goal of food self-sufficiency.¹ Also, the rapid growth in Indonesia's manufacturing output and exports since the mid-1980s, and its strong overall economic performance, have been partly attributed to the industry, trade, and financial liberalization measures introduced in connection with the Bank's Non-Oil Export Promotion and Financial Sector Programs.²

37. It is widely recognized that the policy and institutional framework in a sector is essential for efficient sector growth and development. Policy reforms leading to enhanced mobilization and more efficient utilization of resources are, therefore, considered equally and sometimes more important than the transfer of additional external resources for individual investment projects. Indeed, the experience with development assistance over the past few decades shows that project lending is unlikely to succeed where the policy environment is unsound or distorted. The improvements in sector efficiency and performance made possible by program loan-induced policy reforms therefore represent a substantial benefit of program lending. While it is difficult to attribute adoption of sector reform programs exclusively to the Bank's intervention, it is reasonable to assume that at least some of the reform measures would not have been adopted, or not as rapidly or as completely, without the program loan assistance. This is because the latter provided both leverage to the Bank to press for the adoption of needed reforms, and financial support to the borrowing government to enable their smooth and timely implementation (see section C above).

38. The overall impact of program lending must also be judged in a broader perspective than simply the outcome of the sectoral reforms supported by individual program loans. Bank program loans often implicitly formed part of overall adjustment programs supported by the IMF and World Bank, and comprising stabilization in response to macroeconomic imbalances as well as structural reforms to enhance longer term growth prospects. In addition to the sectoral reforms specifically supported by the Bank's program loans, the latter facilitated implementation of the overall adjustment program by supplementing economywide reforms introduced under IMF and World Bank programs, and by providing the additional finance needed to bridge exceptional financing gaps. Program loans to India and Sri Lanka in the early 1990s, and to several transitional economies more recently, can be considered as examples of such Bank support to structural adjustment programs that helped the recipient countries overcome macroeconomic difficulties while restructuring their economies.

¹ Doc.R61-94, *Loan No. 1045-BAN (SF): Foodcrops Development Program. Progress Report: Release of Second Tranche*, dated 14 April 1994.

² Doc.IN.88-91, *Program Performance Audit Report, Non-Oil Export Promotion Program (Indonesia)*, dated 27 May 1991, and Doc.IN.104-93, *Program Performance Audit Report, Financial Sector Program (Indonesia)*, dated 24 June 1993.

Thus, program lending has made a significant contribution to the overall redirection of economic policies in many DMCs over the last few years, and to the resultant strong economic performance of those DMCs.

39. In 1993, the Bank commissioned a study to determine whether its program loans had caused any adverse impact on the poor.¹ The study is based on a comprehensive analysis of all program loans extended to five South Asian DMCs. The main conclusion is that there was no major negative impact on the poor from the policy conditions attached to Bank program loans in the five countries examined. The net effect on the poor was generally positive, although somewhat limited. Ending price and distribution controls on agricultural inputs usually helped eliminate informal rationing, and thereby improved access of the poor. The cumulative effect of several program loans to a DMC was to reduce budget deficits and, therefore, inflation, which greatly benefited the poor. Industrial deregulation caused hardship for small groups, but also opportunities for the poor. Only one program loan included a measure that could have had a serious negative impact on the poor, i.e., an increase in wheat prices in Pakistan. Partly as a result of this potentially adverse impact, however, the measure was not fully implemented.

40. In the long run, the impact of Bank-supported economic reforms on the poor is clearly positive, as reforms are designed to stimulate rapid, labor-intensive growth, which represents the most effective means for achieving broad-based and sustainable reduction of poverty. The poor rely primarily on their unskilled labor as a source of income, and increasing the demand for such labor is key to reducing poverty (although complementary measures, e.g., to increase social sector spending, upgrade worker skills, or improve food security, are also critical). Temporary negative impacts of program loans on limited subgroups are, however, possible, and systematic efforts to identify and mitigate such impacts should be made. The regional TA has developed a methodology for identifying adverse social impacts, and its application in program loans is now a standard requirement. In general, however, criticisms relating to the adverse social impact of economic reform are, to a certain extent, based on the subsuming of structural reforms within macroeconomic stabilization. Stabilization programs may indeed be harmful to the poor in the short run, as aggregate consumption and output contract, and the poor are often least able to protect their share of national income. Stabilization, however, is also generally unavoidable when a country faces severe BOP difficulties and has exhausted its foreign currency reserves and borrowing capacity. Also, in the Asian context (with some exceptions, e.g., the transitional economies of Central Asia), the general absence of severe macroeconomic disequilibria has limited the need for drastic stabilization, while the presence of a conducive growth environment has helped speed recovery and thus mitigate adverse impacts on the poor.

41. Environmental issues have been addressed in a number of program loans, through policy covenants and attached TAs. For example, monitoring of environmental impacts has been established in several cases, industrial pollution control standards defined, regulations for the use of agrochemicals introduced, and regulatory authorities strengthened. Some program loans, such as those in the forestry and fisheries sectors in the Philippines and Nepal, were specifically targeted at environmental concerns. Furthermore, many of the general reform measures included in program loans have broad environmental impacts, e.g., when changes in

¹ TA No. 5508-REG: see footnote 2, page 4.

relative prices affect the production and consumption of specific goods, or when improved security of land tenure alters incentives for sustainable resource management. It is a standard requirement in Bank program loans that the environmental repercussions of the policy and institutional reforms introduced be systematically assessed, and remedial measures and loan covenants formulated where necessary.

E. Conclusion

42. Despite some delays in the compliance with policy conditions included in program loans, the overall direction of policy reform in the Bank's DMCs, and the determination of governments to pursue reform agendas, have generally been satisfactory. This is reflected in the strong economic performance of many developing countries in the region, and the progress made in raising average living standards and improving basic socioeconomic indicators. The remarkable accomplishments of the Bank's DMCs are intrinsically linked to the improvements brought about in their macroeconomic and sectoral policy frameworks. While it may not be possible to directly trace all reforms to specific Bank interventions such as program loans, it is apparent that consistent Bank attention to policy issues, and efforts to promote the adoption of sound, market-oriented policies throughout all Bank operations, have made a significant contribution to the overall redirection of economic policies in the region.

43. The inception of policy-based lending by the Bank in 1987 has also been an important element in the concomitant qualitative shift in Bank operations, with increased emphasis being placed on policy aspects throughout all lending, TA, and advisory activities. Thus, sector as well as project loans increasingly seek to address broad, sectorwide policy issues, and include relevant loan covenants; economic and sector work is specifically designed to support an agenda of policy dialogue and reform; and policy support has been instituted as a key operating objective in the Bank's 1995-1998 MTSF. This gradual transition from a project-financing institution supporting specific capital investments, to a broader development catalyst and agent of change concerned with the overall policy and institutional environment for growth, has been positively supported by the introduction of the policy-based program lending instrument in 1987. Program lending has broadened the Bank's perspective on development issues, and has enabled the Bank to play a larger role and have a wider and deeper impact than would have been possible through project or sector lending alone.

44. The following overall conclusion can be drawn from the review of program lending since 1987: (i) programs were generally well conceived, with rapid incorporation of the lessons learned in some of the earlier program loans contributing to the quality of subsequent programs; (ii) though direct causal links are difficult to establish, program lending can be considered as generally successful in promoting the adoption of market-based, outward-oriented policies; and (iii) program lending provided useful, and at times critical, support to adjustment efforts undertaken by a number of DMCs over the last few years, especially where sectoral reforms supported by program loans formed part of overall adjustment programs comprising short-term stabilization as well as longer term structural reforms. However, experience suggests that some improvements could be made in strengthening linkages between reform measures and program loans, and in promoting local capacities for the design and implementation of reform programs. Also, in some instances, there may have been inadequate appreciation of the political constraints in the DMC concerned, and of the related difficulties and time frame needed for implementing far-reaching reforms. However, there are no universally applicable precepts with respect to the appropriate speed and depth of reform.

Each DMC must determine the policies deemed most appropriate for its development objectives and needs (taking into account, as it sees fit, advice provided by the Bank and other external agencies); while it is up to the Bank to assess, considering the specific circumstances in each country and sector, whether the proposed reform program is substantive and far-reaching enough to lead to a measurable improvement in sector performance, and hence may warrant the provision of program lending support

IV. SECTOR DEVELOPMENT PROGRAMS

A. Definition

45. In addition to policy reform, a sector generally requires physical investment and capacity building as well as to achieve efficient and sustainable growth. To enable the Bank to address underlying sector needs and constraints in a comprehensive fashion, it is proposed that the Bank combine, under appropriate circumstances, program lending, sector/project lending, and TA under a single assistance window. This form of assistance, which may be called the Sector Development Program (SDP), would not represent a new lending instrument *per se*, but merely seeks to combine existing modalities for more effective use. The main advantage would be to foster an integrated and long-term approach to sector needs (including policies, institutions, and investments), and to enhance the Bank's leverage for promoting policy and institutional reform. This reflects the Bank's actual program lending policy, which is to provide "...support to a sector development program involving a varying mix of adjustments in policies, an investment program and institutional enhancement."¹ It is also in line with the Bank's policies on sector loans, which in principle focus on the policy and institutional environment in a sector while leaving the selection and appraisal of individual subprojects largely to the executing agency. However, the integration of different assistance modalities under a single lending window, together with an extended time frame and flexible operational procedures, may often enable the SDP to achieve a more substantive impact than with the separate use of sector or program lending modalities. The use of pure program loans will continue to be appropriate mainly in the early stages of adjustment in a sector, when basic policy reforms must be instituted prior to commencing where they are adequate to address major sector needs. SDPs, however, may be useful where a sector requires both large-scale investment lending and substantive policy reform, and where the latter cannot, or cannot readily, be accomplished without the support of an additional policy-based lending component.

B. Benefits and Scope

46. Compared with project and sector lending, the principal advantage of a SDP would be to ensure that an adequate policy and institutional framework is in place for such investment lending. While project and sector loans increasingly include policy conditionalities and may be able to induce reform in many cases, SDPs would be able to provide specific policy-based assistance in addition to the investment funding.² This could be especially useful

¹ Doc.WP2-90, *A Review of the Bank's Program Lending Policy*, dated 1 March 1990.

² Where policy reforms can be achieved within the framework of project/sector loans and TA alone, without the need for a specific policy-based lending component, such a combination of investment lending and TA could also be considered a SDP. The distinguishing features of a SDP are the comprehensive approach to sector needs (including policies, institutions, and investments), and the long-term perspective adopted.

where a government, although fully committed to reform, faces substantial fiscal, financial, or social costs that arise in connection with the reform program, and that may impede its implementation. A typical example of this would be the restructuring of SOEs, which generally involves substantial up-front costs to clear accumulated liabilities and compensate redundant labor, and often meets strong resistance from labor and other affected groups. Public enterprise reform, including state-owned utilities, manufacturing enterprises, and financial institutions, is expected to play an increasingly prominent part in many sector adjustment programs. Another example would be reductions in import tariffs, which involve loss of revenue to the government and may cause hardship to specific sectors affected by import competition.¹ The counterpart funds accruing to the government under the policy-based lending component of a SDP could be used to cover some of the costs associated with these reforms, or they could be targeted at key social or institutional development needs in the sector by seeking matching expenditure commitments from the beneficiary government (see paras. 58-59). While the program loan component of a SDP could, thus, be useful in facilitating the adoption of particularly difficult or costly reforms, the investment component would bear the principal responsibility for bringing about improvements in sector policies and institutions. In a SDP, the prospect of large-scale investment lending provides the main incentive for governments to institute needed policy reforms, with only additional support provided by a program-lending component. In principle, this complementary and mutually reinforcing impact of policy lending, investment lending, and TA can also be accomplished through the appropriately programmed use of existing assistance modalities. In practice, however, formalizing the linkage between the various lending components within the framework of a SDP could yield considerable benefits in terms of fostering a sectorwide perspective, and gaining enhanced leverage for policy and institutional reform.

47. The inclusion of investment lending in the SDP, along with the greater dedication of counterpart funds to meet sectoral needs, would lend greater substance to the program-lending instrument by supplementing policy reforms with essential capital investments and, where needed, operating budgets. Energy sector programs, for example, could support the restructuring of state-owned utilities and new public or private sector investments along with key policy and regulatory reforms; capital market programs could include the financing of essential market infrastructure, such as automated trading or clearing/depository systems; and road transport programs could supplement regulatory improvements with increased allocations for road maintenance and with financial incentives to replace unsafe or polluting vehicles. SDPs would, thus, provide more focused assistance than traditional program loans, with the majority of funds allocated to development or operating expenditures in the targeted sector rather than meeting economywide budget or foreign currency needs. This would greatly enhance the sector focus and accountability for the use of Bank funds in a SDP.² It may also facilitate adoption of

¹ Policy reforms eligible for program-lending support may also include reduction of subsidies or raising of user charges, e.g., for fertilizers or electricity. While such reforms involve no financial costs to the government and indeed generate public savings, they are often politically difficult to adopt. By making investment lending conditional on suitable price reform, supplemented where needed by a program-lending component to help overcome the resistance of affected user groups, the Bank may play a catalytic role in enabling the government to proceed with the needed reforms.

² In the case of the Philippines Forestry Sector Programs, for example, it could be argued that, for the majority of reforestation activities, an ordinary project lending approach would have permitted greater control over the use of Bank funds, and greater accountability for the results obtained, than was possible with the program lending approach used.

the more difficult reforms by ensuring that a substantial portion of the benefits of Bank assistance flows directly to the sector concerned, in the form of increased capacity and/or improved quality of service, thereby strengthening the support of the relevant line ministry and sectoral agencies for the overall sector program, and enhancing the acceptance by consumers of higher user charges or fees.

48. The provision of attached TA, along with the counterpart funds provided through the program lending components, would also enhance the capacity building impact that can be achieved in a SDP. This would help improve the general quality of sector management, and more specifically facilitate the adoption and implementation of sound sector policies. Targeted efforts to strengthen policy analysis and evaluation capacities in the sector can help foster government ownership of the reform program, and can enhance local capabilities to monitor reform implementation, evaluate economic and social impacts, and refine and adjust policies in accordance.

49. An initial review of the SDP modality should be undertaken in about three years, when enough experience with the formulation, processing, and initial implementation of SDPs has been gained to allow lessons to be drawn with regard to their design and usefulness. Apart from refining various policy and procedural aspects, this may lead to broader recommendations on the appropriate scope and criteria for the use of SDPs. In the initial phase, however, and until such experience becomes available, due caution will be exercised in the use of SDPs. Thus, rather than being viewed as a standard instrument to be used in all DMCs and all sectors, the SDP approach would be selectively considered where there is a clear benefit in adding a policy-based to an investment lending component, in terms of significantly enhancing the prospects for policy reform. This could for example be the case where a government, although firmly committed to reform, faces serious financial constraints to its implementation, or has failed in past attempts to reform because of entrenched domestic resistance. In such cases, the policy-based lending component would generally need to involve front-loading of the more difficult reform measures, both as an indication of government commitment to the reforms and as a guarantee of their effective and timely implementation. In any event, the program lending component of a SDP should be carefully targeted at issues that are policy-related and that require program loan assistance to be resolved, while other sectors needs and issues should rather be addressed through investment components or TAs.

50. Subject to satisfactory implementation experience, SDPs might eventually replace the existing program and sector lending modalities. The SDP approach provides the Bank with the flexibility to devise an assistance mix of policy and investment-based lending (and technical assistance) as suited to specific sector circumstances. Traditional program and sector loans could, thus, be viewed as merely particular cases of SDPs. While sector loans would continue to be the preferred modes of assistance where policy reforms are not required, or can be accomplished without the need for a program lending component, pure program loans would generally be appropriate only in the early stages of adjustment in a DMC and sector, where deep-seated distortions must be addressed and basic sectoral reforms, involving protracted implementation periods, must be instituted first, to lay the foundation for successful investment operations at a later stage.

51. The rationale for the program lending component of SDPs would lie in sector-specific considerations, such as the need for policy and institutional change in the sector, and the cost and difficulty of the associated reforms, rather than overall BOP or fiscal needs as in

the case of many traditional program loans. The SDP approach would, thus, help further clarify the division of labor among MDBs, with the Bank focusing on purely sector-related assistance while the IMF and World Bank take responsibility for macroeconomic policies and developments.¹

52. Program loans for indirect BOP or fiscal support, complementing IMF/World Bank adjustment programs, will be provided only under exceptional circumstances in the future. Such program loans have played a critical part in supporting the overall structural adjustment efforts of many DMCs in the past, by complementing economywide reforms introduced under IMF and World Bank programs with specific reforms in key sectors of the economy, and by providing the resources need to fill exceptional financing gaps and thereby help establish a stable framework within which longer term reform initiatives could be pursued. However, such macroeconomic-related type of assistance by the Bank will generally be appropriate only in the early stages of adjustment, especially in the transition from a centrally planned or statist to a market-oriented development model. Many DMCs are presently at a more advanced stage in the adjustment process, where it is preferable for the Bank to focus on purely sector-related assistance, leaving the responsibility for macroeconomic adjustment operations to IMF and World Bank. In more advanced DMCs, where exchange controls have been substantially relaxed or entirely abolished, future BOP crises would most likely take the form of sudden outflows of commercial capital, as experienced by Mexico in late 1994. Apart from the limited (although uncertain) likelihood of such crises in many of the Bank's DMCs, the responses demanded under such circumstances involve primarily macroeconomic adjustments, and the resources needed for effective external assistance would vastly exceed the amounts that could be provided through program loans.² Furthermore, the limited time frame available would generally preclude the formulation of sound sector reform programs. Program lending in support of an overall structural adjustment program could, however, still be useful in some of the less advanced DMCs, especially where the size of the BOP or fiscal needs, and the extent of policy distortions, are such that coordinated assistance by all MDBs is required. Under such conditions, program loan assistance by the Bank may be essential to meet the emergency financing needs of the DMC and promote the adoption of essential policy reforms in key sectors. This would, however, be considered under exceptional circumstances only, and would generally be limited to special types of borrowers such as the traditional economies, Pacific DMCs, and new member countries or previously inactive borrowers.

C. Application

53. The investment component of a SDP involves primarily public sector investments, and as such would seem to apply in particular to the physical and social infrastructure sectors, where continued direct government involvement is likely and warranted. It could, however, be equally useful in sectors such as finance, industry, or agriculture, where, despite a gradual shift towards private sector-led development, substantial one-off infusions of public funds may be required for restructuring SOEs. Where appropriate, SDPs could also include a private sector investment fund, channeled through competent financial intermediaries,

¹ In some DMCs, however, where the Bank acts as the lead external agency and plays a key role in macroeconomic management, the scope of program lending/SDPs may exceed the boundaries of individual sectors. This may in particular apply to certain Pacific DMCs, where the Bank assumes overall responsibility for coordinating external assistance and advising on macroeconomic policies.

² IMF is currently in the process of augmenting its resources, and refining its policies, to deal with such eventualities in the future.

to stimulate a private sector supply response to a sector reform program. While the resources for private sector investment should normally come from private sources, with the role of public funds limited to creating a conducive environment for private investment, a Bank-supported private sector fund could be useful where the availability of term finance is a key constraint to private sector development. This could be especially relevant in the transitional economies, where there may be merit in channelling long-term resources to the nascent private sector rather than providing budgetary support to the government through a traditional program loan.

54. Where overall sector reforms have already been carried out, SDPs can focus on subsectors with both significant scope for reform and large investment needs (for example, public manufacturing enterprises within the industry sector, or the capital market within the financial sector). Subsectoral SDPs may also be appropriate where, on the other hand, comprehensive sector reform appears to pose difficulties, but problems in specific subsectors, can be addressed independently. In general, the comprehensive approach to addressing underlying needs and constraints may make a SDP more suitable for more narrowly defined sectors or subsectors. For instance, it may be more practical to address key policy reform and investment needs in the road subsector than in transportation at large, or in the oil subsector than in energy. Prerequisites for such an approach are that linkages with the overall sector as well as with the macroeconomy are duly taken into account, and that the envisaged reforms are sufficient to overcome the principal constraints in the targeted subsector.

55. SDPs might be especially well suited to the social and environmental areas. In addition to essential capacity building efforts, SDPs in the social sectors could include a relatively large policy-based component to support substantive and politically sensitive reforms in social sector policies. This could encompass, for example, improved targeting of health or education subsidies to the poor, with cross-subsidization from more affluent consumers; special emphasis on enhancing the access of women and other disadvantaged groups to social services; and shifts in overall expenditure patterns, e.g., from freely tertiary to universal primary education, or from curative health care in urban hospitals to basic and preventive care in rural aidposts. Social sectors generally also require significant institutional development and local cost and recurrent financing, which can partly be provided through counterpart funds (see paras. 58-59) in conjunction with TAs.

56. Similarly, in the environment area, a working paper of the Bank's Office of Environment and Social Development¹ has identified scope for program loans specifically aimed at environmental concerns, but argues that a "hybrid" lending instrument combining policy measures with physical investment may be more appropriate in those circumstances. Sustainable development requires both adoption of stricter environmental standards and resources to implement and enforce the latter. This seems to indicate that targeted environmental SDPs could be particularly well suited to address the Bank's strategic concern for sustainable development and could help enhance the Bank's impact in this area.

57. The term "sector" in the definition of a SDP (or program loan) should, thus, be understood in a broader sense than usual. In addition to the traditional concept of a sector, it could include subsectors of more limited scope, or it might relate to broad cross-sectoral themes

¹ *Environmental Considerations in Program Lending: A Review of Bank's Experience*, Working Paper, dated December 1995.

such as environmental protection, poverty reduction, or women in development. It might also include cross-sectoral concerns of a more macroeconomic nature, such as public enterprise reform, tax reform, or central banking reform. The key attributes in each case are the close interrelationship between the various aspects covered by a SDP, in terms of pertaining to the same type of activity or to similar objectives, and the ability to effect a measurable improvement in the targeted areas through the combined use of investment, policy, and technical assistance interventions.

D. Counterpart Funds

58. The 1987 policy review envisaged a selective increase in the use of counterpart funds for specific sector development purposes. Some critics have observed that, because of the fungibility of funds entering the national treasury, as well as general reservations with regard to the earmarking of fiscal revenues, issues in this respect should be addressed through general reviews of the level and composition of public expenditure and of budgeting procedures employed. Also, tight constraints on the dedication of counterpart funds have generally been imposed where IMF/World Bank adjustment programs were being pursued concurrently, since these typically involve stringent public spending controls and agreed-upon public expenditure programs. Actual, as opposed to nominal, dedication of counterpart funds has therefore been rare in program loans. Nevertheless, counterpart funds represent net additional resources accruing to the borrowing government,¹ and use of these funds as an incentive for the government to budget for critical sector expenditures may often be justified. This may be especially true where a reform program entails social costs, that are borne by sectors of society other than the government (see Chapter III). In view of the fungibility of funds, matching expenditure commitments (in the form of policy covenants) should, however, be sought from the borrowing government, rather than earmarking of the specific counterpart funds generated. Such expenditure commitments should result from a broad review of the entire allocation of public resources to and within the sector, and of budgeting processes and accountability of the implementing agencies, with a view to ensuring that expenditures considered essential are effectively met. Where the pattern of public spending in the sector is considered suboptimal, matching expenditure commitments with the overall fiscal framework established under ongoing IMF and World Bank adjustment budgetary resources generated by a program loan should be reached during loan negotiations, and should be documented in the loan agreement, and explained and justified in the Report and Recommendation of the President (RRP).

59. Typically, the two most prominent areas for matching expenditure commitments will be the strengthening of sector institutions and the mitigation of adverse social impacts of reform. The former could be a highly useful complement to traditional capacity-building efforts through the provision of TA; specifically, matching expenditures could help ensure that adequate local currency financing and counterpart staff are available to meet the development needs of sector institutions, and allow them to draw the full benefit from consultants and studies provided under TAs. As to the inclusion of mitigative social measures, it represents an essential response to a long-standing criticism of adjustment lending. For example, safety nets and

¹ Though not additional, for the economy, to the foreign exchange inflow of the program loan.

retraining schemes for redundant workers could be established,¹ labor-intensive public works programs launched, or microenterprise development fostered. Low-pay, labor-intensive public works programs could be especially useful both for short-term poverty reduction and the creation/rehabilitation of essential assets, such as rural roads or schools. Similarly, microenterprise finance schemes coupled with suitable training and advisory services could help provide alternative income-earning opportunities for the poor. Where relevant, adequate budget provision for such programs should be covenanted in program loan/SDP design. If necessary, a special project to address social concerns could also be formulated in parallel with a program loan or SDP. Such an approach was, for example, adopted in Papua New Guinea, where the Special Interventions Loan was approved subsequent to the Agriculture Sector Program Loan in 1990, with the specific objective of generating employment opportunities and mitigating the adverse social impact of Bank-supported and other ongoing adjustment programs in the country.

E. Sector Analysis

60. SDPs must be based on comprehensive sector analysis and policy dialogue, covering sector investment plans, institutional development needs, and social and environmental aspects as well as policy issues. Depending on the sector, this would normally include a core sector investment plan, or an outline of broad investment priorities. Projects departments would be responsible for sector analysis and SDP formulation, in close collaboration with programs and other departments concerned. Use of project preparatory TA or staff consultants for the preparation of SDPs will generally be appropriate, provided that close and continuous involvement of Bank staff is ensured at all stages.

61. The sector study preceding formulation of a SDP should include a detailed analysis of economic issues in the sector, including the regulatory framework, incentive structure, financial sustainability, and relative roles of the public and private sector. In addition, the SDP study should give attention to the following four areas:

- (i) social analysis, including proposed mitigative measures for the poor and other vulnerable groups affected by the reforms (the Bank's regional TA on the Social Impact of Program Lending has developed a methodology for systematically identifying and assessing impacts on the poor, which should be followed for that purpose); in addition to mitigating potential adverse impacts, SDPs should generally seek to address social concerns in the sector, and promote human development and equity where possible; the social analysis should, thus, ascertain whether sector growth is being pursued with adequate attention to equitable distribution of benefits, whether it contributes to equal opportunities for disadvantaged groups such as women and indigenous people, and whether it incorporates participatory approaches;
- (ii) environmental issues in the sector, including regulatory changes, monitoring and enforcement, and investments needed to address key environmental concerns;

¹ While surplus workers in the formal manufacturing sector are usually not poor, and indeed often form part of a labor elite, their living standards can be seriously affected by the reforms, and they may pose considerable political opposition to the latter unless properly compensated. Use of counterpart funds to finance redundancy payments for workers losing their jobs as a result of public enterprise reform or trade liberalization may, therefore, often be useful.

- (iii) capacity-building requirements, notably strengthening of key sector institutions and need for additional issues-oriented studies; and
- (iv) a survey of private sector needs and constraints, to ensure that a suitable supply response to the reform program will be forthcoming (especially in the industry and agriculture sectors).

F. Operational Procedures

62. Definition of the Bank's focal sectors of assistance in a DMC is one of the main tasks of the Country Operational Strategy Study (COSS); identification and formulation of SDPs would be a natural corollary of this process. The COSS typically identifies major policy constraints in key sectors in the DMC. Following further discussion with the government, a SDP could then be formulated where agreement is reached, or appears possible, on a core sector reform package. For example, the COSS could establish that a DMC faces massive investment needs in both its power and road subsectors, but that issues of cost recovery and performance of state utilities in the former, and of user charges and maintenance allocations and practices in the latter, would need to be addressed prior to considering substantive Bank assistance. Agreement with the government on a suitable reform package to deal with these issues could then form the basis for a comprehensive, multiyear program of investment lending, TA, and policy support, under the auspices of a SDP.¹ The possibility of adding a program to an investment lending component could thus enable the Bank to achieve greater policy leverage in all its operations, by insisting on a sound policy framework as a strict precondition for Bank intervention in a sector. The possibility of allowing a policy-based lending component could thus be viewed as the counterpart of the greater stringency in making all Bank assistance contingent on the adoption of suitable policies.

63. The RRP for a SDP would summarize the findings and conclusion of the sector study, and set out in detail the understandings reached with the government in the attendant policy discussions. Together with indicative long-term plans for investment, policy reform, and capacity building in the sector, the SDP would provide for approval of an initial time-slice of the envisaged assistance program, generally including investment (sector or project) lending, policy (program) lending, and TAs. A single RRP and loan agreement covering the investment and the program component would be submitted for Board consideration. The SDP would not provide for "blanket" approval of the long-term assistance plan, with the subsequent approval of individual components delegated to Management; Board approval would be sought only for a combined sector or project loan, program loan, and TAs, with the outline of long-term sector development plans included in the RRP to place the current assistance program in the proper perspective.

64. Tranching of the program lending component will be determined on case-by-case basis, depending on the agreed upon time frame for the adoption of reforms, the financial needs of the borrower, and the interface with the investment component. Because tranching of project loans is generally not feasible, front-loading of key policy conditionalities may often be required where severe sector distortions are in evidence. Where, however, a gradual approach

¹ As indicated in the footnote to para. 46, this does not necessarily mean that a policy-based component must be included in the SDP.

to reform is adopted, the investment component of the SDP may comprise a suitably phased sector loan, with continued eligibility for subproject approvals in each successive phase conditioned on the timely implementation of agreed upon reforms.

G. Strategic Implications

65. The SDP approach will help maximize the developmental impact of Bank operations, by ensuring that all lending and advisory activities are integrated into an overall sector perspective. Rather than discrete and isolated activities, individual loan and TA operations would be viewed as building blocks towards the attainment of broader sectoral objectives, with issues of complementarity between Bank interventions, adequacy of the sector policy and institutional framework, and coordination with other external agencies, systematically addressed within the context of a SDP. While efforts to integrate all Bank operations into such an overall perspective have, implicitly or explicitly, always been made,¹ adoption of the SDP may help reinforce and systematize this process.

66. The SDP could play an important role in implementing the new directions set out in the Bank's 1995-1998 MTSF. The latter seeks to enhance the Bank's developmental and catalytic impact by focusing attention on policy support, capacity building, and regional cooperation as key operating objectives, in addition to investment financing. The SDP establishes a clear linkage between efforts to improve the mobilization and use of resources in a sector through the adoption of sound policies, and the volume and composition of Bank assistance. As well as ensuring that sound policy framework is in place for its investment lending, the SDP would thus enable the Bank to enhance its catalytic impact on policy and institutional reform through its investment operations (see para. 62).²

67. A relatively large volume of resources would often be required in a SDP, to enable the Bank to meet underlying sector needs in a comprehensive manner. The total size of a SDP would depend on the Bank's overall lending program in the recipient country, sector investment needs, the strength and costs of the reform package, and intersectoral priorities. A balance would, thus, be struck between the need to address major sector needs and constraints in a SDP, and the demands of, and scope for assistance in, other sectors of the DMC. Also, substantial additional financing for the sector concerned could be raised in future Bank operations, and through cofinancing. The holistic approach to sector development should be especially helpful in attracting cofinancing from both official and commercial sources. While this would enable to spread the financing load, the SDP approach is likely to lead to greater sectoral concentration of Bank operations in a DMC, in line with the recommendations of the MTSF.

H. Risks and Issues

68. Introduction of the SDP presents a number of potential issues that must be carefully examined. None of these, however, appear to pose major difficulties:

¹ Country programming thus seeks to ensure that all loan and TA operations included in the country program are firmly grounded in the Bank's operational strategy for the country and sector concerned.

² As stated in the 1995-1998 MTSF: "The issue is the extent to which the Bank can expand this role of policy support, making the progression of policy changes in a sector the cornerstone of its assistance, and using its investment operations to more widely influence and promote policy change and reform in key sectors in DMCs."

- (i) In 1985, the World Bank introduced a "hybrid loan" instrument combining policy-based and investment lending. The use of this lending modality has remained limited, and no conclusive evidence concerning its design and impact is available. However, some concerns are noted, and the Bank has attempted to take account of these in designing the SDP. The scope and conditions for the use of hybrid loans appear to be somewhat ill defined, with a policy component often added *ad hoc* to a sector investment loan in order to achieve larger resource transfers. Furthermore, in some cases, either the policy or the investment lending component have been insufficiently prepared. These concerns would be addressed in the SDP by (a) the requirement for particularly difficult or costly reform measures to justify the program lending component; (b) the prior completion of a comprehensive sector study; (c) the integrated, sectorwide approach adopted; and (d) the full preparation of all individual SDP components to usual Bank standards.
- (ii) The design and implementation of such an all-encompassing assistance program may pose difficulties in practice; separate processing of complementary program loans, sector/project loans, and TAs may seem more practical. However, given the flexible operational procedures adopted, and the front-loading of key policy conditions together with phasing of the investment program, design and implementation of a SDP should pose no more difficulties than would separate processing of individual lending components. Conversely, the SDP would have significant advantages in fostering an integrated, long-term approach to sector needs, and in enhancing leverage for policy and institutional reform by providing large-scale investment lending as well as policy-based lending component.
- (iii) Tranching is difficult for project-related funds, since the Bank cannot easily halt or suspend disbursement for investment loans in the case of policy slippages. The same, however, applies to project and sector loans, and can be addressed in a SDP through proper front-loading of the relevant policy conditionalities and, where feasible, phasing of the investment program.
- (iv) Because large amounts of funds may be required to support policy reform and to meet sector investment needs, SDPs may lead to greater sectoral concentration of Bank operations in a DMC, with implications for the workload of various operational units. This, however, is consistent with the Bank's MTSF, and represents in fact a significant advantage of the SDP approach (see para. 67).

V. DESIGN AND PROCEDURES

69. A number of practical recommendations are presented in this chapter to strengthen the design, processing, and administration procedures for program loans. The principal measures envisaged are listed below. They represent essentially good practices in

program lending. While some are already routinely followed in program loans, others are not, or not systematically, applied; further institutionalizing the relevant requirements may help ensure more consistent application. "Program Loan" hereunder refers both to the traditional program lending instrument and to the policy component of the proposed SDPs (although some of the practices recommended here would be automatically followed in the context of a SDP).

70. Recommendations relate to the following principal areas:

- (i) **Sector Selection.** Program loan and SDP assistance should be carefully targeted at those sectors or subsectors where the government is firmly committed to reform, but where serious financial or social constraints are likely to hinder the smooth and timely implementation of reforms. In all cases, strong government ownership of the reform program is essential, with only additional support provided through a policy-based lending component. The use of program loans/SDPs should also be limited to those areas where the Bank has genuine expertise, and adequate experience to provide well-founded advice on the formulation and implementation of reform programs.
- (ii) **Sector Analysis.** A comprehensive sector study must be carried out prior to considering a program loan or SDP. In addition to policy issues, the study should devote special attention to social and environmental issues and to institutional development needs in the sector. An assessment of the impact of reform on the poor and other vulnerable groups must be prepared in all cases, following the methodology outlined in the relevant staff instructions and guidelines. The sector study should also, as far as possible, establish benchmark data on sector performance, including physical, economic, and social indicators, that can be monitored throughout program implementation and serve as a basis for postevaluation.
- (iii) **Logical Framework.** A program (logical) framework should be prepared for all program loans and SDPs, to highlight the key interrelationships underpinning program design, notably causality links between policy reforms and expected sectoral achievements; set out monitorable targets for program activities, outputs, and objectives; and spell out assumptions with regard to complementary elements needed to achieve program objectives.
- (iv) **Program Content.** Comprehensive and far-reaching reform addressing all major sector distortions would normally be required in each program loan/SDP. However, in view of the dislocations often caused by drastic policy changes, and the sometimes adverse short-term impact of reform on specific groups, an incremental pace of reform may often be necessary. Where justified, the Bank should therefore be able to support a gradualist approach to reform, as suited to country and sector circumstances. This may be accomplished through a succession of program loans/SDPs, or through the adoption of a longer time frame together with multiple tranching.
- (v) **Additionality.** Duplication with reform measures already included under IMF or World Bank programs is possible where such measures form an essential part of the sector reform program supported by the Bank. The bulk of the Bank's

program should, however, represent commitments that are additional to those already entered into with other external agencies. The RRP should clearly indicate which, if any, reform measures in the sector the borrower is already committed to under ongoing adjustment or other externally assisted programs.

- (vi) **Macroeconomic Linkage.** All program loans/SDPs must take the linkage between the sectoral program and the macroeconomy into account. In particular, the decision on whether to proceed with a program loan must consider the effect of untied capital inflows on money supply and exchange rate; in countries facing a surfeit of capital inflows and foreign currency, the Bank should generally refrain from extending program loans, which may exacerbate pressure on the exchange rate and inflation (except where the amount of the loan is so small as to have a negligible impact on monetary aggregates). Also, as for all Bank operations, the general direction of macroeconomic conditions and policies in the borrowing country must be deemed satisfactory for a program loan or SDP to be considered.
- (vii) **Aid Coordination.** The Bank will systematically consult and closely coordinate with IMF; the World Bank; and, where applicable, important bilateral donors in formulating and implementing program loans/SDPs. Where SECALs have been devised by the World Bank, the Bank may usefully complement these with parallel or follow-up investment loans/SDPs in the same sector. Aid coordination will in particular address the interface of the Bank-supported program with macroeconomic aspects, including the adequacy of the macroeconomic framework for successful implementation of the sector program, and the potential impact of the latter on macroeconomic variables (see subparagraph [vi] above). Also, where IMF or World Bank adjustment programs are ongoing, the consistency of the envisaged use of counterpart funds with the fiscal framework established under the latter needs to be ensured.
- (viii) **Loan Size.** The determination of the amount of a program loan requires the exercise of judgment. The key factors to be considered are the estimated short- to medium-term costs of the reform program (in fiscal and/or BOP terms),¹ the strength of the reform package, and the relative importance of the sector. Within these broad parameters, the size of the program loan should generally be set at the smallest possible level to achieve the desired reforms. The borrower would, thus, normally be expected to absorb at least part of the adjustment costs involved. The program loan amount would also not normally exceed a reasonable proportion of the Bank's total annual lending program in the borrowing country concerned. While no simple, objective formula can be devised, careful consideration of these factors should provide adequate guidance for the reasonable determination of program loan amount in each case. A detailed explanation of the rationale for arriving at the proposed loan amount should be provided in the RRP.

¹ While it is not easy to estimate precisely the net fiscal or BOP impact of a reform program, systematic efforts to identify and quantify major short- or medium-term costs should be made.

- (ix) **Technical Assistance.** The TAs attached to program loans and SDPs should be carefully targeted to meet key capacity-building needs in the sector and/or address major policy issues having a bearing on future strategy decisions. The number and design of attached TAs must be geared to the absorptive capacity of the executing agencies involved. Close supervision of TA execution by the Bank, and incorporation of their findings in ongoing policy dialogue, are an essential part of program loan/SDP administration.
- (x) **Counterpart Funds.** All program loans/SDPs should include a broad review of budgetary allocations to and within the sector, with a view to ensuring that essential expenditures are met. Where shortfalls in the allocation of development or operating expenditures to the sector are identified, the program loan/SDP should seek to correct these, to the extent feasible, by obtaining matching expenditure commitments from the borrowing government in exchange for the counterpart funds generated. Such matching expenditure commitments would, where applicable, take the form of policy covenants, and would be documented in the loan agreement and indicated in the policy matrix. In all cases, agreement on the appropriate use of the additional budgetary resources generated by a program loan should be reached during loan negotiations, and should be specified and explained in the RFP.
- (xi) **Social Protection.** Especially in countries undergoing structural adjustment programs, program loans could be targeted at the social sectors, and encompass safety nets or welfare schemes designed to mitigate the sometimes adverse short-term impact of adjustment on the poor. Though World Bank adjustment programs increasingly pay attention to social aspects and generally now include mitigative measures for the poor and other affected groups, the Bank may be able to play a useful role in supplementing and extending such schemes. In particular, counterpart funds may be used to mitigate potential adverse impacts of reform, e.g., by financing the establishment of safety nets for redundant workers. Where applicable, counterpart funds, as well as policy reforms, could also be used to generally promote social development objectives in the sector concerned.
- (xii) **Performance Record.** The implementation experience with past program loans, as well as with policy conditions attached to investment loans in the same DMC and sector, is a critical factor for determining eligibility for program loans. This should cover not only the status of second tranche release of ongoing program loans in the DMC, but also postevaluation results of completed program and project/sector loans. Where serious problems were experienced with other program loans in the same DMC, processing of further program loans or SDPs would need to be particularly well justified, and would be contingent on substantial front-loading of the relevant conditionalities. If the planned program loan/SDP concerns the same sector where major implementation difficulties were encountered in the DMC concerned, or involves measures similar to those that caused difficulties before (e.g., retrenchment of surplus labor), then the Bank would not normally proceed with another program loan/SDP unless the most difficult measures are adopted up-front. Front-loading will also be required where policy slippages, though in unrelated areas, may indicate generally weak government commitment to reform.

- (xiii) **Political Economy.** An analysis of the likely impact of the proposed reforms on various interest groups should be carried out. Where serious opposition to the reforms can be expected, measures to overcome the latter (such as compensatory payments to displaced workers) should be discussed and, if necessary, incorporated in the program. This discussion, together with the preceding analysis of the performance record of the government, constitutes an essential part of the risk analysis for program loans.
- (xiv) **Tranching.** Each tranche release should be based on a certain number of specific, i.e., time-bound and objectively monitorable, conditions. Covenanted conditions should relate to essential policy objectives only. A balanced distribution of conditionalities among program loan tranches should generally be sought, including, where necessary, front-loading of key reform measures. This may include allowance for prior action, where the relevant reforms were adopted within a reasonable time period prior to tranche release and were clearly related to policy dialogue undertaken by the Bank. Also, as suggested in subparagraph (iv), more than two tranches may be appropriate in some cases, especially where far-reaching and substantive reforms are to be implemented over an extended period of time.
- (xv) **Program Period.** The program period should generally correspond more closely to the program loan disbursement schedule, with the release of tranches tied to the adoption of specific reform measures. Thus, program loans should generally avoid leaving substantial reforms outstanding after the release of the last tranche. Where, however, a gradual approach to reform is adopted and a longer time frame is, therefore, needed, this may be accommodated through either an extended program period together with multiple tranching, or a succession of shorter program loans of generally smaller amounts financing specific stages of the reform process. The latter approach may often be preferable, in view of the need to continuously adapt sector plans and policies in line with changing circumstances and priorities, and the resultant difficulty in establishing firm *a priori* sector plans over along-term horizon.
- (xvi) **Policy Dialogue.** In view of the importance attached to policy dialogue, and the frequent inclusion of far-reaching reforms involving decisions at the highest levels of authority in the DMC government, it may often be appropriate for senior Bank officials to be directly associated with key phases of the policy dialogue.
- (xvii) **Political Subdivision.** Program loans and SDPs at the state/provincial level could be considered selectively in DMCs and sectors where sufficient policy autonomy exists at such lower levels of government, and where there are no legal or administrative barriers to such loans. This could be especially relevant in larger DMCs with a federal government structure, where certain sector policies fall largely under the authority of state/provincial governments, and where successful reform in one state is likely to have a strong demonstrational impact on other states. Such program loans/SDPs would have the same type and degree of conditionality as national level programs. Also, full concurrence of the national government, and ability to address all relevant sector issues, would be required. The financial arrangements between the federal/central and the

state/provincial government would need to be clarified; the latter would normally receive the proceeds (i.e., the net budgetary resources), but would also shoulder the debt-servicing costs of the loan, with the Bank's policies on relending generally applying to the latter.

- (xviii) **Cofinancing.** The scope for official and commercial cofinancing should be systematically explored in program loans and SDPs. As cofinancing becomes an integral part of country strategy and programming, program loans/SDPs may provide a well-suited vehicle for such efforts at external resource mobilization. SDPs may be especially well suited to attract cofinancing from official bilateral and from commercial sources, as they help create a conducive environment for investment in the sector, and enhance the confidence of potential cofinanciers that underlying sector issues and constraints are being addressed in a comprehensive fashion.
- (xix) **Procurement.** No substantive purpose appears to be served by existing limitations on procurement and disbursement, such as insistence on low thresholds for international competitive bidding or application of sector-specific positive import lists. The objective of a program loan is to provide financial support to a government to facilitate the implementation of needed policy reforms, not to finance sector import requirements. However, where the foreign exchange provided by the Bank is used for procurement by public sector agencies rather than private commercial importers, the Bank will review the standard public sector procurement procedures used in the DMC to ensure that they are adequate from the points of view of competition and efficiency and consistent with the general principles of good governance. Also, where exchange controls are in effect, the Bank will review the general foreign exchange allocation mechanism in the DMC with regard to its efficiency and transparency; where these cannot be guaranteed, remedial steps should be adopted as an integral part of program design.¹ Finally, in accordance with the Charter provisions, the Bank will continue to ensure that program loan proceeds are used for procurement in and from member countries, and that the standard exclusion ("negative") list applies.
- (xx) **Retroactive Financing.** Since program loans are designed to provide budgetary and/or BOP support for the implementation of policy reforms, the disbursement schedule should be tied to the incurrence of the relevant costs. Retroactive financing will, therefore, generally not be necessary or appropriate, since the reform programs to be supported will normally be forward looking. Where, however, reforms were introduced prior to program loan approval as a condition for Board consideration, and the associated costs have thus already been incurred, or where costs are likely to be incurred shortly after Board approval, retroactive financing could be permitted selectively to help defray the relevant costs.

¹ A rational and transparent foreign exchange allocation mechanism forms part of a conducive macroeconomic framework for a successful sector program (see subparagraph [vi]).

- (xxi) **Supervision.** Substantial administration responsibilities may often be devolved to resident missions, which have an especially important role to play in providing insights on social and political developments in the borrowing country, and maintaining continuity of policy dialogue throughout program design and implementation.
- (xxii) **Evaluation.** In midterm and postevaluation reviews, special attention should be paid to the attainment of underlying sector objectives, in addition to compliance with policy conditions. Use of the program (logical) framework and of performance indicators and benchmark data established at the program design stage (see subparagraphs [ii] and [iii] above), would facilitate subsequent impact assessment and postevaluation.
- (xxiii) **Ceilings.** The program lending components of SDPs, together with traditional program loans, will continue to be subject to the present ceiling of 15 percent of total Bank lending. However, to accommodate large demands for policy-based assistance that may occur in a particular year, this will continue to be flexibly interpreted as a three-year moving average centered on the current year. Also, if the SDP concept proves successful and becomes used on a wide scale to promote sector policy reforms, a relaxation of the present ceiling could be considered during the next review of the Bank's program-lending policies and SDPs in about three years.

VI. CONCLUSION AND RECOMMENDATIONS

71. The following general conclusions emerge from the review of program lending operations and policies:

- (i) Post-1987 program loans were generally well conceived and designed, with rapid incorporation of the lessons learned in some of the earlier program loans contributing to the quality of subsequent programs. Also, despite some delays, a vast majority of reform measures included in program loans were successfully implemented. The improvements in sector efficiency and performance made possible by Bank-supported policy reforms represent a substantial benefit of program lending. While it is difficult to attribute the adoption of sectoral reform programs exclusively to the Bank's assistance, it is apparent that program loans have played a significant part by providing both leverage to the Bank to press for the adoption of needed reforms, and financial support to the government to enable their smooth and speedy implementation.
- (ii) Program loans also provided useful, and at times critical, support to overall adjustment efforts undertaken by a number of DMCs over the last few years, especially where sectoral reforms supported by program loans formed part of IMF/World Bank-supported adjustment programs comprising short-term stabilization as well as longer term structural reforms. In addition to the sector reforms specifically supported by the Bank's program loans, the latter facilitated implementation of the overall adjustment program by supplementing economywide reforms introduced under IMF and World Bank programs in key

sectors of the economy, and by providing the additional finance needed to bridge exceptional financing gaps and/or alleviate severe fiscal constraints.

- (iii) The overall direction of policy reform in many of the Bank's DMCs over the past 10-15 years has been satisfactory, as reflected in their strong economic performance and progress made in improving average living standards and socioeconomic indicators. The remarkable accomplishments of the Bank's DMCs are closely linked to the improvements brought about in their macroeconomic and sectoral policy frameworks. Although there are many factors explaining the redirection of economic policies in the region, program lending, through its support to sectoral and economywide adjustment programs, and through the increased emphasis on policy issues that it has fostered throughout all Bank operations, has been a valuable and significant contributory factor. Program lending has broadened the Bank's perspective on development issues, and has enabled the Bank to play a larger role and have a wider and deeper impact than would have been possible through project or sector lending alone.
- (iv) Because of the long time lags involved, postevaluation results on a broad cross-section of post-1987 program loans will not become available for another 2-3 years. It is recommended that systematic analysis of the program lending instrument be undertaken by the Post-Evaluation Office at that time, to derive generic lessons with respect to the design and impact of program loans.

72. The following general thrusts are recommended for the Bank's future program-lending policies:

- (i) In successful adjusting countries and sectors, program lending should generally be followed by investment lending, while further policy adjustment is promoted through policy dialogue, TA, and project and sector lending. However, where a sector requires both substantial investment and policy reform, and where the reforms involve large financial, fiscal, or social costs, the most appropriate means for promoting both policy reform and sound investment lending may often be a SDP, which combines sector/project lending, program lending, and TA. In a SDP, large-scale funding of sectoral investment needs is linked to the adoption of essential policy and institutional reforms; additional support for such reform can be provided through a program-lending component, helping defray specific costs (such as loss of government revenue, compensatory social measures, or institutional reform and development) arising in connection with the sector program, or helping overcome the resistance of affected groups. The combination of assistance modalities within the framework of a SDP, together with the adoption of an extended time frame and flexible operational procedures, would allow the Bank to address underlying sector needs in a more comprehensive fashion, and would enhance its leverage for promoting policy and institutional reform.
- (ii) The SDP approach could play an important role in implementing the new directions set out in the Bank's 1995-1998 MTSF. The SDP would help maximize the development impact of Bank operations by ensuring that all lending and advisory activities are integrated into an overall sector perspective. At the same

time, the SDP would enhance the Bank's policy leverage by further strengthening the linkage between the provision of Bank assistance and the adoption of sound policies in a sector. As well as ensuring that a sound policy framework is in place for its investment lending, the SDP would thus enable the Bank to enhance its catalytic impact on policy and institutional reform. Because a relatively large volume of resources would often be required in a SDP to enable the Bank to meet sector needs in a comprehensive fashion, the SDP would also lead to greater sectoral concentration of Bank operations in a DMC, in line with the recommendations of the MTSF.

- (iii) While the SDP may be useful for fostering policy reform and sound investment lending under given circumstances, it would not be standard instrument to be used in all DMCs and all sectors. Rather, the SDP approach would be appropriate where there is a clear benefit in adding a policy-based to an investment lending component, in terms of significantly enhancing the prospects for policy reform. This could, for example, be the case where a government, although firmly committed to reform, faces serious financial constraints to its implementation, or has encountered strong resistance from affected groups in past attempts to reform. Apart from such special considerations, however, investment lending would continue to bear the main responsibility for bringing about policy reforms, with only additional support provided by a program-lending component designed to facilitate the adoption of particularly difficult or costly reforms.
- (iv) Due caution should also be exercised in the use of SDPs until sufficient experience with regard to their processing and implementation has been gathered. It is, therefore, recommended that an initial review of the SDP modality be undertaken in about three years, when general lessons with regard to their design and usefulness can be drawn. Subject to satisfactory performance, SDPs might replace the existing program and sector lending modalities at that time. The SDP approach provides the Bank with the flexibility to devise an assistance mix of policy and investment-based lending (and TA) as specifically suited to sector circumstances. Traditional program and sector loans could, thus, be viewed as merely particular cases of SDPs. While sector loans would continue to be the preferred modes of assistance where policy reforms are either not required or can be accomplished without a policy-based lending component, pure program loans would generally be appropriate only in the early stages of adjustment in a sector, where deep-seated distortions must be addressed and basic sectoral reforms instituted to lay the foundation for successful investment operations at a later stage.
- (v) Program loans for indirect BOP or fiscal support, complementing IMF/World Bank adjustment programs, will be provided only under exceptional circumstances in the future. While such program loans have played a critical part in supporting the overall structural adjustment efforts of many DMCs in the past 10-15 years, they are generally appropriate in the early stages of adjustment only, especially during the transition from a centrally planned or statist to market-oriented development model. Most DMCs are presently at a more advanced stage in the adjustment process, where it is preferable for the Bank to focus on sector-related assistance,

leaving the responsibility for macroeconomic adjustment operations to IMF and World Bank. Program lending in support of an overall structural adjustment program could, however, still be useful in some less advanced DMCs, especially where the size of the emergency BOP and/or fiscal needs, and the extent of policy distortions, are such that coordinated assistance by all MDBs is required. This, however, would be considered under exceptional circumstances only, and would generally be limited to special types of borrowers such as transitional economies, Pacific DMCs, or new member countries or borrowers.

- (vi) Particular efforts should be devoted to addressing key policy and institutional development needs in the social sectors through program lending and SDPs. Thus, program loans in economies undergoing adjustment could seek to mitigate adverse short-term impacts of adjustment on the poor, through safety nets or targeted welfare schemes; while program loans or SDPs with large policy component could be targeted at the social sectors, e.g., to promote the adoption of policies benefiting the poor and to strengthen sector institutions. The integration of policy and investment lending also makes SDPs especially well suited to address the Bank's concern for sustainable development, by providing support to enhanced environmental standards as well as the resources to implement them.

73. The Board is requested to endorse the general thrust of the new program-lending policy, the SDP modality, and the specific recommendations with regard to the design, processing, and administration procedures for program loans and SDPs as presented in Chapter V.

APPENDIXES

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POLICY-BASED LENDING BY THE WORLD BANK AND OTHER MULTILATERAL INSTITUTIONS

1. The World Bank initiated adjustment lending in the early 1980s, with the first structural adjustment loan (SAL) provided to Kenya in 1980. Throughout the 1980s, adjustment lending assumed increasing importance in World Bank operations, as the principal instrument to deal with the debt crisis affecting many developing countries at the time. Concurrently, the International Monetary Fund (IMF) expanded the scope of its operations in developing countries. IMF loans typically provide liquidity support to countries, facing temporary balance-of-payments (BOP) difficulties; as a condition for such assistance, the recipient country is required to adopt stringent macroeconomic stabilization measures. IMF loans are, thus, akin to policy-based assistance, and early IMF standby credits of the 1950s and 1960s can be regarded as precursors of the World Bank adjustment and Bank program loans that evolved in the 1980s. Typically, developing countries facing severe macroeconomic imbalances, including high inflation, shortage of foreign currency, and external debt-servicing difficulties, undertake both IMF and World Bank adjustment programs, with the IMF focusing on short-term stabilization (including generally devaluation and fiscal and monetary tightening), and the World Bank concentrating on structural reforms (such as adjustments in relative prices, and trade and investment liberalization) designed to raise efficiency and stimulate growth over the longer term.

2. Because of weak BOP positions exacerbated by an unfavorable external environment, many developing countries required urgent BOP support in the early 1980s. Debt-afflicted countries had to postpone capital investments and focus on the utilization of existing capacities, including rationalization of infrastructure and production facilities, and provision of current operating inputs. Adjustment lending allowed the World Bank and IMF to respond to these needs, while at the same time addressing the underlying causes of the difficulties experienced, such as overvalued exchange rates, excessive fiscal deficits, overextended and inefficient public sectors, and distorted incentive and regulatory frameworks. The emphasis on policy reform in adjustment lending also reflected one of the key lessons of experience learned over the previous decades of development assistance, i.e., that it is virtually impossible to design successful projects in an unsound sector or macroeconomic policy environment. Adjustment lending thus grew rapidly to reach over 25 percent of total World Bank lending by the latter part of the 1980s. Overall, adjustment lending since inception has amounted to approximately \$50 billion, or nearly 20 percent of total World Bank lending. Its share in Asia, however, where macroeconomic disequilibria were generally less severe, has remained below 10 percent. After initial efforts at macroeconomic adjustment and economywide structural reforms, the World Bank began to shift attention to sectoral policy reforms in the mid-1980s. Sector adjustment loans (SECALs) thus began to account for the major proportion of adjustment lending. The World Bank has also continually reviewed and amended its adjustment lending policies, to reflect lessons of experience and adapt the instrument to changing instruments. Thus, SALs as well as SECALs show an increasing trend in (i) the number of policy conditions attached to each loan; (ii) the specificity of policy conditions, i.e., their expression in time-bound and quantitative terms; (iii) the average implementation period of reform programs; and (iv) the number of loan tranches. Greater emphasis is also placed on front-loading and prior action on key reform measures.

3. Following the rapid increase in the 1980s, World Bank adjustment lending manifests a declining trend over the recent past. The volume of SALs and SECALs decreased to 17 percent of total World Bank lending in FY1983, and further to 12 percent in FY1994. In FY1995, adjustment lending recovered to 24 percent of World Bank commitments; however, if rehabilitation-import and debt-reduction loans are excluded, the share of adjustment lending is only 16 percent. The relative decline reflects the renewed access of some major beneficiary countries to international capital markets. However, the continued needs in sub-Saharan Africa and other regions, the renewed BOP strains in several countries following the recent financial crisis in Mexico, and new requirements from the formerly centrally planned economies in transition should ensure that adjustment lending will continue to play an important, if somewhat less prominent, role in overall World Bank operations.

4. Despite its widespread application throughout the developing world, adjustment lending has been subject to persistent debate and controversy. Major criticisms include (i) deviation from the World Bank's traditional role as a project lender; (ii) infringement on the sovereignty of borrowing countries; (iii) reliance on the universal applicability of the liberal, market-oriented development mode; (iv) excessive focus on austerity at the expense of investment and growth; and (v) insufficient attention to the social impact of adjustment, and imposition of undue hardships on the poor. Nevertheless, periodic reviews by the World Bank, as well as by a variety of other sources, seem to indicate that structural adjustment has been successful overall in easing the strains of austerity rendered unavoidable by severe macroeconomic imbalances, and in supporting the transition of heavily regulated and inward-looking economies to more market-friendly, outward-oriented policy regimes.

5. The latest comprehensive review by the World Bank of its experience with adjustment lending was carried out in 1992.¹ Based on a systematic comparison of three groups of countries categorized by the intensity of adjustment lending, the review concludes that adjustment lending (SALs and SECALs) was, on average, associated with both improved policy performance and a recovery in aggregate growth rates. After controlling for different initial conditions, external shocks, and official capital inflows, adjustment is shown to raise average growth rates by about 4 percentage points for middle-income countries, and 2 percentage points for low-income countries. Adjustment is also clearly correlated with improved policy frameworks, e.g., in terms of reduced fiscal deficits, more realistic exchange rates, and lower import tariffs. Of a sample of 81 postevaluated structural and sector adjustment operations, 24 percent were judged highly satisfactory, 42 percent satisfactory, 18 percent unsatisfactory, and 16 percent very unsatisfactory. Two thirds of adjustment operations were thus considered to have had satisfactory outcomes.

6. Two significant concerns are, however, noted. One is that, with the exception of a few high-performing economies (notably in East Asia), the adjustment process generally takes time, and significant costs arise during the transition. The initial phases of adjustment are typically associated with recession, which affects consumption of the poor as well as nonpoor. In some cases, overall income declines are exacerbated by adverse distributional shifts. Public investment is squeezed by tight overall spending constraints, while private investment declines

¹ World Bank Doc. R92-47, *Third Report on Adjustment Lending: Private and Public Resources for Growth*, dated 24 March 1992.

because of depressed demand, loss of protection, higher interest rates, and uncertainty in the policy environment. While investment normally recovers after a period of time, as overall economic conditions improve and the reforms take hold, the corresponding time lag may be quite long, sometimes exceeding five years. Indeed, evidence from some low-income countries, especially in sub-Saharan Africa, suggests that, while adjustment may be a necessary condition for the resumption of growth, it is not *per se* sufficient, and needs to be supplemented by measures such as the establishment of a conducive business environment; financial sector reform; resumption of positive net external resource flows; and investment in human resource development, infrastructure, and capacity building. The second key problem concerns the need for a reallocation of public expenditure in addition to an overall reduction of the fiscal deficit. Too often, spending cuts have been achieved at the expense of critical operation and maintenance expenditures, while spending allocations within the social sectors remain distorted, and subsidies, transfers to loss-incurring state-owned enterprises, and public sector employment all continue to be excessive. World Bank adjustment programs now increasingly seek to address these problems. To the extent applicable, they are also reflected in the design of Bank program loans, though the generally more favorable conditions in Asian developing member countries render the issues of public expenditure reform and private investment recovery somewhat less urgent. However, the social impact of reforms, especially during the initial contraction period, has received increased Bank attention.

7. With the exception of the European Bank for Reconstruction and Development (EBRD), the other regional multilateral development banks possess policy-based lending instruments similar to the Bank's program loan. The Inter-American Development Bank (IADB) introduced a quick-disbursing sector lending facility in 1990 to support policy and institutional reforms in specific sectors or subsectors. IADB sector loans can also address issues that are macroeconomic in nature, such as tax reform or trade liberalization. Sector lending by IADB grew rapidly to \$1.5 billion-\$2 billion in 1991 and 1992, equivalent to over a quarter of total IADB lending; however, it declined to about \$500 million in 1993 and \$300 million in 1994. Quick-disbursing policy-based loans also play an important part in the operations of the African Development Bank (AfDB), reflecting the large resource transfer and policy reform needs of many of its member countries. However, many AfDB policy loans involve merely cofinancing of IMF- and/or World Bank-supported structural adjustment programs. EBRD does not engage in policy or adjustment lending, principally because of its focus on private sector/project finance. The long time frame involved in acquiring the relevant policy analysis and advisory skills, and the risk of overlap and duplication with the Bretton Woods institutions, may also have played a part in EBRD's decision not to engage in such operations.

PRINCIPAL FEATURES OF THE BANK'S EXISTING PROGRAM-LENDING POLICY

1. Program loans support a medium-term sector or subsector development program, expressed in quantitative terms to the extent feasible, and involving a mix of adjustments in policies, investment plans, and institutional enhancement. The program seeks to address constraints and opportunities that are underlying and sectorwide in nature, or that bear upon linkages between the sector and the macroeconomy. The program should normally be broad enough to encompass the full range of sector-specific issues.
2. Program formulation must be based on comprehensive sector analysis to identify structural constraints to sector development, and on extensive policy dialogue with the borrowing government to determine the means for addressing these constraints.
3. The sector program resulting from the sector studies and policy dialogue must have the full commitment and support of the developing member country (DMC) government. It should be presented in the Development Policy Letter, addressed from a senior government official to the President of the Bank.
4. The program must be fully consistent with the Bank's operational strategy for the DMC concerned, and with the DMC's own development plans and priorities.
5. The program should be closely coordinated with the activities of the International Monetary Fund, World Bank, and, where appropriate, important bilateral donors in the DMC.
6. The size of a program loan is related to a variety of factors including the Bank's overall lending program in the DMC (which depends, *inter alia*, on the size of the country in terms of population and gross domestic product, its financing gap, development performance, and absorptive capacity); the importance of the sector and intersectoral priorities; the scope and strength of the reform program; and other sector-specific considerations. There are no objective criteria for determining loan size, and the Bank's takes the above factors into consideration.
7. Reform programs typically extend over 3-5 years. The utilization period of loan proceeds is, however, shorter — normally around 1-3 years.
8. Where major elements of a program are to be implemented subsequent to loan approval, tranching is considered appropriate to monitor and expedite program implementation. Conditions of tranche release, i.e., policy conditions to be satisfied prior to the release, should be realistic and achievable, as well as few in number. Prior to tranche release, a progress report is circulated to the Board. If the Bank recommends amendment or waiver of covenanted conditions, Board approval will be sought on a no-objection basis.
9. Where policy adjustments are required over an extended period of time, a succession of program loans can be envisaged to sustain the reform process. Approval of successor program loans will be subject to satisfactory progress in the preceding programs.

10. Considerable flexibility exists for the use of loan proceeds. Proceeds are normally disbursed against broad sector import needs defined by reference to a positive list. Where the sector relates to the entire economy (e.g., finance), proceeds can be utilized for economywide imports subject to a negative list. To facilitate quick disbursement, retroactive financing up to 180 days prior to loan effectiveness is permitted. Imprest account and/or statement of expenditures procedures are normally used.

11. For procurement, international competitive bidding (ICB) is required only above a threshold to be determined case by case in light of relevant procedures in the borrowing DMC, utilizing the criteria of economy and efficiency. Ex-post review by the Bank with right of reversal is considered sufficient for ICB procurement. Procurement below the ICB threshold is governed by normal commercial practice in the private sector and by government guidelines for the public sector. Procurement of internationally traded commodities, such as fertilizer or oil, is not subject to mandatory ICB.

12. Advisory technical assistance can be attached to program loans, and is frequently used for studies on important policy issues, and for strengthening key sector institutions.

13. On a case-by-case basis, counterpart funds may be used to provide local cost financing for specific development needs in the designated sector. Counterpart funds can also be applied to the local currency costs of ongoing Bank-supported projects in the DMC.

14. Program lending is subject to a ceiling of 15 percent of total Bank lending. To accommodate heavy demands that may arise in a given year, this is flexibly interpreted as a three-year moving average centered on the current year. An additional limit of 22.5 percent of total Asian Development Fund (ADF) lending was imposed by the donors in the latest ADF VI replenishment. Individual country ceilings for program lending were abolished in 1987. Customary practice, however, is to support not more than one program in a country per year.

APPROVED PROGRAM LOANS
(November 1987 - December 1995)

Country	Program Title	OCR	ADF (\$ Million)	Total	Date of Approval
Indonesia	Non-Oil Export Promotion Program	75	75	150	17 Dec 1987
Philippines	Forestry Sector Program	60	60	120	28 Jun 1988
Bangladesh	Industrial Program	-	65	65	30 Jun 1988
Fiji	Agriculture Diversification Program	20	-	20	29 Sep 1988
Nepal	Agriculture Program	-	55	55	24 Nov 1988
Pakistan	Industrial Sector Program	100	100	200	13 Dec 1988
Indonesia	Financial Sector Program	150	50	200	20 Dec 1988
Lao PDR	Agriculture Program	-	20	20	3 Aug 1989
Philippines	Fisheries Sector Program	30	50	80	26 Sep 1989
Sri Lanka	Agriculture Program	-	80	80	28 Nov 1989
Western Samoa	Agriculture Development Program	-	15	15	28 Nov 1989
Papua New Guinea	Agriculture Sector Program	24	56	80	12 Dec 1989
Indonesia	Food Crop Sector Program	150	100	250	13 Mar 1990
Nepal	Forestry Sector Program	-	40	40	23 Oct 1990
Bangladesh	Foodcrops Development Program	-	125	125	6 Nov 1990
Philippines	Road and Road Transport Program	50	50	100	8 Nov 1990
Sri Lanka	Financial Sector Program	-	80	80	20 Nov 1990
Lao PDR	Financial Sector Program	-	25	25	06 Dec 1990
Pakistan	Agriculture Program	-	200	200	11 Dec 1990
Sri Lanka	Agriculture Program II	-	60	60	26 Nov 1991
Bangladesh	Industrial Program II	-	125	125	17 Dec 1991
India	Hydrocarbon Sector Program	250	-	250	17 Dec 1991
Indonesia	Financial Sector Program II	250	-	250	19 Mar 1992
Lao PDR	Agriculture Program II	-	30	30	8 Oct 1992
India	Financial Sector Program	300	-	300	15 Dec 1992
Nepal	Industrial Sector Program	-	21	21	27 Apr 1993
Mongolia	Industrial Sector Program	-	30	30	17 Aug 1993
Bangladesh	Railway Recovery Program	-	80	80	8 Sep 1994
Viet Nam	Agriculture Sector Program	-	80	80	8 Dec 1994
Philippines	Capital Market Development Program	150	-	150	22 Aug 1995
Kazakhstan	Agriculture Sector Program	100	-	100	23 Nov 1995
Kyrgyz Republic	Agriculture Sector Program	-	40	40	23 Nov 1995
India	Capital Market Development Program	250	-	250	28 Nov 1995
Mongolia	Agriculture Sector Program	-	35	35	5 Dec 1995
TOTAL		1,959	1,747	3,706	

Source: ADB, Central Operations Services Office, *Summary Report on the ADB's Lending, Technical Assistance and Private Sector Operations*, various issues.

Table 1: Program Lending by Year

Year	No. of Programs (no.)	Amount (\$ million)			Percentage of Total Program Lending		
		OCR	ADF	Total	OCR	ADF	Total
1988	6	330	330	660	16.0	30.5	21.0
1989	5	54	221	275	2.4	6.2	7.6
1990	7	200	620	820	8.0	41.9	20.6
1991	3	250	185	435	7.3	13.7	9.2
1992	3	550	30	580	13.9	2.6	11.4
1993	2	0	51	51	0.0	3.9	1.0
1994	2	0	160	160	0.0	13.6	4.3
1995	5	500	75	575	12.3	5.2	10.4
Total	33	1,884	1,672	3,556	9.1	14.5	11.1

Note: Excludes the Indonesia Non-Oil Export Promotion Program approved in December 1987.

Source: Derived from Appendix 3.

**Table 2: Program Lending by Country
(November 1987 - December 1995)**

Year	No. of Programs (no.)	Amount in \$ million			Percentage of Total Program Lending		
		OCR	ADF	Total	OCR	ADF	Total
Indonesia	4	625	225	850	31.9	12.9	22.9
India	3	800	0	800	40.8	0.0	21.6
Philippines	4	290	160	450	14.8	9.2	12.1
Pakistan	2	100	300	400	5.1	17.2	10.8
Bangladesh	4	0	395	395	0.0	22.6	10.7
Sri Lanka	3	0	220	220	0.0	12.6	5.9
Nepal	3	0	116	116	0.0	6.6	3.1
Kazakhstan	1	100	0	100	5.1	0.0	2.7
Papua New Guinea	1	24	56	80	1.2	3.2	2.2
Viet Nam	1	0	80	80	0.0	4.6	2.2
Lao PDR	3	0	75	75	0.0	4.3	2.0
Mongolia	2	0	65	65	0.0	3.7	1.8
Kyrgyz Republic	1	0	40	40	0.0	2.3	1.1
Fiji	1	20	0	20	1.0	0.0	0.5
Western Samoa	1	0	15	15	0.0	0.9	0.4
Total	34	1,959	1,747	3,706	100.0	100.0	100.0

Source: Derived from Appendix 3.

**Table: Program Lending by Sector
(November 1987 - December 1995)**

Sector	Programs (no.)	Amount (\$ million)	Percentage of Total Program Lending	
			Number of Programs	Amount
Agriculture	18	1430	52.9	38.6
Finance	7	1255	20.6	33.9
Industry	6	591	17.6	15.9
Energy	1	250	2.9	6.7
Transport	2	180	5.9	4.9
Total	34	3,706	100.0	100.0

Source: Derived from Appendix 3.

TYPICAL REFORM AGENDAS IN BANK PROGRAM LOANS

1. **Agriculture.** The key reform measures in agriculture sector program loans are generally (i) reduction and/or elimination of input subsidies, especially on fertilizers; (ii) increased recovery of irrigation costs; (iii) raising of interest rates on agricultural credit; (iv) enhanced taxation of agricultural income and wealth; (v) removal and/or rationalization of price controls on farm produce; (vi) rationalization of public foodgrain procurement and distribution; (vii) abolition of state monopolies over agricultural input and output trading; (viii) external trade liberalization, including elimination/reduction of import barriers and export taxes; and (ix) increased security of land tenure.

2. **Industry.** Industry sector programs generally seek to enhance efficiency in the manufacturing subsector through increased internal and external competition. The programs typically encompass measures to (i) reduce losses and encourage corporatization, commercialization, and/or privatization of state-owned enterprises; (ii) ease licensing requirements and other barriers to entry and investment; (iii) enhance the scope for private sector participation in industry; (iv) facilitate foreign investment; (v) abolish import licensing and quantitative restrictions, and reduce import tariffs; (vi) establish incentives for exporters (such as duty-free access to imported inputs and technology); and (vii) deregulate factor (labor and capital) markets.

3. **Finance.** Financial sector (including capital market) programs seek to enhance the efficiency of financial intermediation by (i) limiting the scope of directed credit; (ii) deregulating and/or rationalizing interest rates (including abolition of interest subsidies for preferred types of borrowers, such as agriculture or small-scale industry); (iii) reducing public sector preemption of financial sector resources;¹ (iv) increasing the autonomy of state-owned financial institutions; (v) promoting private financial intermediation; (vi) enhancing competition within the financial sector by removing barriers to entry and market segmentation; (vii) improving the ability of the central bank to conduct monetary policy through open market operations; (viii) promoting development of a debt securities market by establishing interest rate benchmarks and enhancing liquidity; (ix) easing regulatory and infrastructure bottlenecks to capital market development, such as administrative controls over share issue prices, inadequate disclosure and investor protection rules, and outdated trading and clearance and settlement systems; and (x) strengthening the regulatory and supervisory framework for the financial system, including capital adequacy ratios, portfolio classification and loan-loss provisioning standards, and exposure guidelines.

¹ Typically, in the form of high mandatory reserve requirements, deposited at low or no interest with the central bank of lent to state enterprises.