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Policy-Based Lending at the IDB

IDB IDB Invest

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ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
AfDB	African Development Bank
CCF	Contingent Credit Facility
CPE	Country Program Evaluation
CS	Country Strategy
DDO	Deferred drawdown option
DSL	Development sustainability credit line
ESG	Environmental, Social and Corporate Governance
GDP	Gross Domestic Product
IAMC	Independent Assessment of Macroeconomic Conditions
IBRD	International Bank for Reconstruction and Development
ICPR	Independent Country Program Review
IDA	International Development Association
IDB	Inter-American Development Bank
IEG	Independent Evaluation Group
IMF	International Monetary Fund
INV	Investment loan
LAC	Latin America and the Caribbean
LBR	Loan based on results
LIC	Low-income country
M&E	Monitoring and Evaluation
MDB	Multilateral Development Bank
MIC	Middle-income country
OVE	Office of Evaluation and Oversight
PBL	Policy-based loan
PBP	Programmatic policy-based loan
PCR	Project completion report
PFM	Public financial management
SDL	Special development loan
SG	Sovereign-guaranteed
SPD	Office of Strategic Planning and Development Effectiveness
TA	Technical assistance
TC	Technical cooperation operation
XCPE	Extended Country Program Evaluation

EXECUTIVE SUMMARY

This note presents findings and insights from different sources and constitutes the first building block for the Office of Evaluation and Oversight's (OVE) policy-based lending evaluation. Prior evaluation work by OVE and the evaluation departments of other Multilateral Development Banks (MDBs), as well as Inter-American Development Bank's (IDB) project databases, provide a rich source of information on the use and characteristics of policy-based lending. This paper synthesizes findings and insights from: (i) OVE's 2015 review of the design and use of policy-based lending (document RE-485-6); (ii) OVE's 2020 Lending instruments study (document RE-549); (iii) OVE's review of the demand and performance of policy-based lending in its country products (Country Program Evaluations or CPEs, Extended Country Program Evaluations or XCPE, and Independent Country Program Reviews or ICPR); (iv) OVE's validations of IDB's self-evaluations of completed operations (project completion report or PCR); (v) the proceedings of a 2020 conference describing the experience with policy-based lending at the Asian Development Bank (ADB), African Development Bank (AfDB), and the World Bank (WB); and (vi) a portfolio analysis of policy-based operations approved up to December 2022.

Since the introduction of policy-based lending in the IDB in 1989, its use has substantially increased, and variations of the modality have been added, such as the programmatic policy-based loan (introduced in 2005) or the deferred-drawdown option (introduced in 2012). As the appetite for policy-based lending increased in the region, the IDB implemented different limits to the use of policy-based lending. In its most recent iteration, the limit for policy-based lending increased from 30% to 40% in response to the COVID-19 pandemic. This temporary change expired at the end of 2022.

Most MDBs have a policy-based lending category, and the programmatic series modality has replaced stand-alone categories in recent years. All MDBs place an implicit or explicit cap for policy-based lending between 20-30% of all lending to avoid crowding out investment lending. Policy-based lending has gained in importance in all MDBs, and the volume of loans and their share in total lending has increased sharply during and right after crises (in 2008–10, 2015–16, 2020–21), approaching (and in some cases exceeding) 30% of total MDB lending. Policy-based funding is not tied to specific goods, works, or budget items. The loan size is primarily related to financing needs, not the cost of the supported reforms. Evaluations also found that for MDBs to be effective in policy support, the programs must be complemented with other instruments beyond budget support, including policy diagnostics and technical assistance.

Between 2005 and 2022, IDB approved 332 policy-based operations totaling almost US$59.7 billion. About 83% of these operations were approved as part of a programmatic series. Policy-based lending accounted for 31.1% of IDB's sovereign-guaranteed approvals in that period, with the share increasing from 19% in 2005–2009 to 27% in 2010-2014, 37% in 2015–2019, and 42% in 2020-2022. All countries, except Venezuela, have made use of policy-based lending in the past, and for some countries, including Chile, Colombia, Dominican Republic, Jamaica, Mexico, Panama, and Uruguay, policy-based lending has been the dominating modality between 2015-2022. Since 2010, its use has become more diverse sector-wise, as lending increased in other sectors than public sector governance and economic management.

Previous OVE's analysis suggests that among the range of reasons for using policy-lending across countries, a predominant use has been for budget and debt financing, especially in times of need, including the recent response to the COVID-19 crisis.

Econometric analysis (OVE, 2015a) found that policy-based lending was negatively correlated with a country's growth rate, and positively correlated with the size of fiscal deficits and gross financing needs. Previous OVE's work shows that countries' financing objectives were a key motivation for the use of policy-based lending, both to handle short-term financing needs, debt management, and to face contingent shocks. The use of policy-based lending for budget support purposes was found to be particularly pertinent for small economies, which tended to be more vulnerable to external economic shocks and for which IDB financing could be decisive in helping them to weather a storm. Another important driver of policy-based lending use is the seal of approval provided by the involvement of the IDB, which can help to legitimize a policy reform process and provide valuable technical inputs.

Not completing a programmatic policy-based series as planned (called truncation) is a common phenomenon that can affect the effectiveness of the planned reforms and create sunk costs. Of the 156 programs approved between 2005 and 2022, 79 (50%) have been completed, 50 (32%) operations have been truncated, and 28 (18%) are still ongoing, resulting in a truncation rate of 39%. Since programmatic policy-based series regularly have less low-depth conditions at the end of the series (lacking the capacity to trigger long-lasting policy or institutional changes), truncation implies that some of the most consequential reforms or activities may never carried out. Furthermore, as the transactional costs of a programmatic policy-based series are front-loaded, with many of the activities occurring prior to approval, truncation creates sunk costs. Truncation rates vary significantly across countries yet somewhat less across sectors.

The Project Completion Review ratings of operations validated by OVE show that policy-based operations scored slightly better than investment loans, as 60% of policy-based operations completed between 2017-2022 achieved positive overall outcomes compared to 56% for investment loans. Similarly, the share of policy-based loans with a positive effectiveness rating is 40% compared to 30% for investment loans.

In the last Annual Meeting in Panama in March 2023, IDB Governors resolved to mandate the IDB Board of Executive Directors to direct IDB Management to prepare a proposal for a new institutional strategy and a series of operational reforms (document AG-6/23). These reforms comprise a review of IDB's current lending instruments, including ways for strengthening policy-based lending (document AG-7/22, the Washington Resolution). This note and the subsequent evaluation can provide important information for the Board and Management in the discussions to attend the operational reforms commanded by the Governors.

I. INTRODUCTION

1.1 **The Inter-American Development Bank Group (IDBG) has various sovereign-guaranteed (SG) lending categories.** IDB's SG lending includes investment lending (INVs), policy-based lending (see Box 1.1), and lending for financial emergencies during a macroeconomic crisis, called special development lending (SDL). In addition, IDB also guarantees loans made by private financiers for public sector projects. Policy-based lending provides fast-disbursing financial assistance or country budget support that is conditional on the borrowing country fulfilling a set of agreed-upon policy and institutional reforms. INVs disburse against specific predefined project expenditures or meeting agreed-on development results (the latter, in the case of loans based on results (LBRs), a special instrument within the investment category). SDLs provide fast-disbursing support conditional on a country being struck by a macroeconomic crisis, being supported by an active International Monetary Fund (IMF) program, and the SDL being part of an international support package.

1.2 **Policy-based lending has played an increasing role in the IDB to support country-led policy reforms. Yet, the Office of Evaluation and Oversight (OVE) has not undertaken a full-fledged evaluation of IDB's policy-based lending to date.** OVE has looked at policy-based lending in several contexts, including country products and evaluations, the validation of Project Completion Reports (PCRs), and specific studies. Following a synthesis study on lending instruments (Lending instruments report, document RE-549) and an evaluation of IDB Group's Guarantees (Evaluation of Guarantee Instruments at the IDB Group, document RE-559-1), OVE's work program (Proposed Work Program and Budget of the Office of Evaluation and Oversight, 2023-2024, document RE-574) included an evaluation of IDB's policy-based lending. The work program also underlined the need for an in-depth analysis of how best to evaluate policy-based lending prior to the evaluation itself.

1.3 **This technical note and the subsequent evaluation that OVE is preparing can contribute to addressing the IDB Governors' mandates.** In the last Annual Meeting in Panama in March 2023, the Governors resolved to mandate the IDB Board of Executive Directors to direct IDB Management to prepare a proposal for a new institutional strategy and a series of operational reforms (document AG-6/23). These reforms comprise a review of IDB's current lending instruments, including ways for strengthening policy-based lending (document AG-7/22, the Washington Resolution). This note and the subsequent evaluation can provide important information for the Board and Management in the discussions to attend the operational reforms commanded by the Governors.

1.4 **This note presents findings and insights from different sources and constitutes the first building block for OVE's policy-based lending evaluation.** Prior evaluation work by OVE and the evaluation departments of other MDBs, as well as IDB's project databases, provide a rich source of information on the use and characteristics of policy-based lending. This paper synthesizes findings and insights from: (i) OVE's 2015 review of the design and use of policy-based lending (document RE-485-6); (ii) OVE's 2020 Lending instruments study (document RE-549); (iii) OVE's review of the demand and performance of policy-based lending in its country products (Country Program Evaluations or CPEs, Extended Country Program Evaluations or XCPE, and Independent Country

Program Reviews or ICPR)[1]; (iv) OVE's validations of IDB's self-evaluations of completed operations (project completion report or PCR); (v) the proceedings of a 2020 conference describing the experience with policy-based lending at the Asian Development Bank (ADB), African Development Bank (AfDB), and the World Bank (WB) ; and (vi) a portfolio analysis of policy-based operations approved up to December 2022.

Box 1.1. IDB policy-based products

Multi-tranche Policy-Based Loan (PBL): PBLs consist of two or more tranches within a single operation, in which the disbursement conditions for each tranche are specified at the beginning of the operation (PR-301).

Programmatic Policy-Based Loan (PBP): PBPs are a series of technically related but financially/contractually independent operations. The independent single-tranche operations are approved on a phased basis (and have their own loan contract) to support the borrower in achieving the country's reform program, with specified triggers for moving from one operation to the next (PR-301).

Hybrid Loans: Hybrid loans provide financial support for sector or subsector policy changes and funds for capital investment. They contain a policy reform (fast disbursement) component to finance a variety of expenditures linked to policy changes and institutional reform and an investment component targeted to specific investments in the sector, which helps consolidate these new sector policies. (PR-301).

Deferred Drawdown Option (DDO): DDOs can be requested for all policy-based modalities (multi-tranche, programmatic, and hybrid - in this case, to the policy component). The purpose of the DDO is to allow the loan resources to be drawn down over a period so long as the conditions that led to approval remain in place. This option allows countries to approve their allocation of policy-based lending in a given year but have access to the financial resources at a time that meets their needs more effectively. (GN-2677-2).

Policy-Based Guarantees: A policy-based guarantee is a policy-based instrument that combines features of the policy-based operation with a guarantee. Once the government complies with the policy reforms, the Bank issues a guarantee to support the Guaranteed Instrument (BA-U0001).

1.5 **The remainder of this note is divided into eight sections.** The following section presents policy-based lending in the IDB. Section III summarizes the insights from policy-based evaluations in other MDBs, Section VI describes the evolution of the IDB's policy-based lending portfolio from 2005 to 2022. Section V presents OVE findings regarding demand drivers of policy-based lending and the depth of their policy conditions. Section VI presents OVE's findings on the implementation of policy-based operations, looking at truncation. Section VII presents the findings of validated management's self-evaluations (PCR) of policy-based operations. Finally, section VIII concludes.

II. POLICY-BASED LENDING IN THE IDB

2.1 **Policy-based operations were introduced in the IDB in 1989 in response to the Latin American and the Caribbean (LAC) debt crisis of the 1980s** (see document AB-1378 on Seventh Capital Replenishment). It was based on the model of conditional budget support created by the World Bank (WB) almost a decade earlier. Originally called sector loans, IDB's policy-based operations were intended to support the twin objectives of promoting policy or institutional reform and helping countries meet their financing needs, supporting countries pursue macroeconomic adjustment programs while supporting structural reforms. Multi-tranche PBLs (the main policy-based operation type in the IDB up to 2005) were

[1] After 2021, OVE conducts only Extended Country Program Evaluations (XCPE) and Independent Country Program Reviews (ICPR), which replace Country Program Evaluations (CPE).

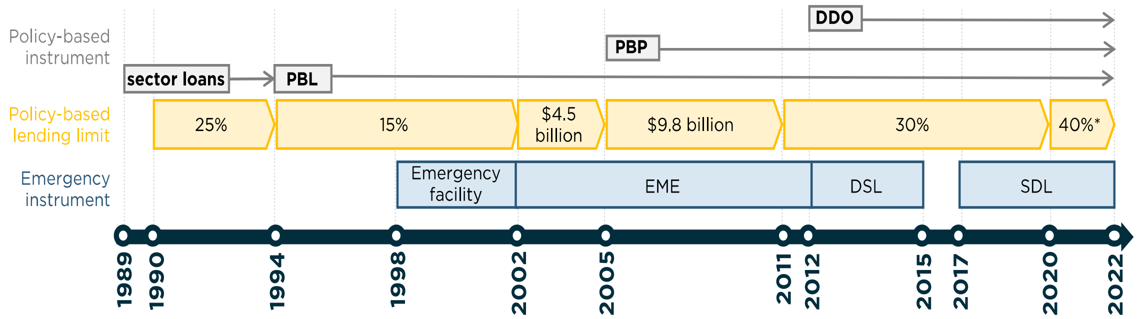
to be disbursed in several tranches with disbursements conditioned on maintaining a sustainable macroeconomic policy framework and compliance with a set of agreed-upon conditions defined in a policy matrix. PBL processes required a country policy memo to ensure that the conditions were being complied with and relied on IMF-supported programs for macroeconomic assessments. Policy-based lending was capped at 25% of IDB's 1990–1993 overall lending program.

2.2 **The policy-based lending cap was repeatedly modified in the following years.** By the time of its Eighth Capital Replenishment in 1994, Governors foresaw that policy lending during that replenishment would have a greater focus on reforms of the overall functioning of the public sector, including social sector policy reform and the efficiency of service delivery (document AB-1704).[2] While policy-based operations maintained their twin objectives, Governors envisioned smaller loans than those supporting macroeconomic adjustment and debt reduction typical of the Seventh Capital Replenishment. Consequently, under the Eight Capital Replenishment, the cap for policy-based lending was reduced from 25% to 15% of the cumulative lending program (see Figure 2.1. for a timeline). The effects of the Asian financial crisis in 1997–1998 made adhering to the new cap difficult; and led to the introduction of an emergency loan window, which was not subject to the policy-based lending cap (document RE-251). In the early 2000s, demand for policy-based lending continued to exceed the 15% lending limit. This led to three modifications in 2002: i) the 15% ceiling was replaced by an amount of US$4.5 billion for 2002–2004; ii) a new emergency lending category (EME) was established; and iii) a minimum disbursement period of 18 months across PBL tranches was introduced, mostly to avoid crowding out the new emergency lending instrument. Also, IDB started to supplement the traditional policy matrix with a results matrix in its PBL documents.

2.3 **In the mid-2000s, internal processes for PBLs were changed and new modalities were added.** As borrowing countries were experiencing higher growth, increased institutional capacity, and better access to capital markets, IDB introduced more changes to policy-based lending. First, the 18-month minimum disbursement period for PBL was eliminated in 2002 (see document GN-2233-2). Second, the new PBP modality was introduced in 2005 (see Box 1.1 and Figure 2.1). The PBP consists of a series of single-tranche operations set in a medium-term framework of reforms. The first operation of a PBP series identifies the policy conditions for that operation and the indicative triggers for the subsequent loans in the series. Since the triggers can be revisited at each loan approval, PBP series allow conditions to be adjusted as country circumstances change. With these changes, IDB also approved guidelines for preparing and implementing policy-based operations in 2005 (document CC-6005), thus, consolidating existing policies and practices for the first time), thus, consolidating existing policies and practices for the first time**.** These guidelines were later updated in 2018 (document CS-3633-2).

2 "Policy lending during the Eighth Replenishment will continue to support economic adjustment programs for those countries still in need of such financing, but greater emphasis will be on reforms in the public sector (i.e., in tax, budget and expenditure policies, institutional strengthening and support for sub-national governments), and promoting reforms in sectors neglected in the general adjustment process, in particular the rehabilitation and modernization of social sector infrastructure and delivery systems." (Document AB-1378, paragraph 2.52).

Figure 2.1. Evolution of budget support and Emergency Lending Instruments at IDB



Source: OVE, 2015a (document RE-485-6).
Notes: DDO = deferred draw-down option, DSL = development sustainability credit line, EME= emergency loan, PBL = policy-based loan, PBP = programmatic policy-based loan, SDL = special development loan, *temporary response to COVID-19 pandemic.

2.4 **More recently, policy-based lending limits have been raised further and a the DDO has been added.** The dollar-denominated cap on policy-based lending established for 2002–2004 was initially extended for 2005–2010 by US9.8 billion, but in 2011 the ceiling for policy-based lending was changed to 30% of total approved non-emergency lending.[3] More recently, to facilitate IDB's response to the COVID-19 crisis, the ceiling was increased to 40% of total non-emergency lending for the period 2019-2022.[4] In 2012, IDB also introduced a DDO to synchronize proceeds with countries' financing needs (document GN-2667-2). The DDO allows countries, on payment of an up-front premium, to draw on the resources of a policy-based operation when they require these funds. During the drawdown period, the borrower must maintain policy conditions and sustainable macroeconomic policies. In 2014, further actions were taken to decouple IDB's policy-based lending from the IMF's assessment of macroeconomic conditions (document GN-2753-7). IDB decided to strengthen its own macroeconomic assessment capacity and no longer make policy-based lending conditional on an on-track IMF program, Article IV, or IMF letter of comfort.

2.5 **On the emergency lending side, the temporary emergency loan window was replaced by a consecutive series of emergency lending instruments** (by the EME, the development sustainability credit line (DSL) and the SDL). As mentioned before, the initial temporary emergency loan window established in response to the 1997–1998 financial crisis (document RE-231) was replaced by the EME in 2002[5]. The EME was capped at US$6 billion and was in turn replaced by the DSL in 2012 (document RE-549). The DSL was a contingent credit line whose funds could be withdrawn at a time of a crisis, but it had to be approved before the crisis. It was geared toward providing liquidity during financial distress while protecting expenditures for programs directed at the poor. It expired in 2015 and was replaced by the SDL in 2017 (document AB-3134). While an SDL does not require an IDB-specific IAMC, it is

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3 According to the document GN-3079 the cap is calculated as share of policy based lending in the total of non-emergency lending with Ordinary Capital (including the lending approved by IDB Invest cross booked at the Bank's balance sheet) on four-year periods (resolution AG-9/11).

4 The policy-based lending cap of 30% applies to total lending financed with IDB's Ordinary Capital over consecutive four-year periods. For concessional lending, the cap is applied on a biannual basis. The temporary 40% cap increase applied to the 4-year period ending in December 2022. For concessional resources from the Ordinary Capital, the increased policy-based lending cap of 40% applies to lending for 2021–2022.

conditional on a country experiencing a macroeconomic crisis and being supported by an existing IMF program. SDLs cannot exceed US$500 million or 2% of a country's Gross Domestic Product (GDP) if supported by fresh funds. It can also be funded through a reallocation of uncommitted loan balances, provided that at least 60% of the remaining uncommitted loan balances are INVs.

2.6 **Cofinancing of IDB policy-based lending has been minimal since the mid-2000s.** Most of IDB's policy-based lending cofinancing occurred in the early days of the instrument, especially in the first two years of the instrument's existence when a partnership with the WB was mandatory. Since the mid-2000s, IDB has financed almost all policy-based operations on its own. Similarly, in the early years of policy-based lending, operations used to be approved when the borrowing country had an IMF-supported program in place: 90% of policy-based lending approvals between 1995 and 2003 were granted to countries with an IMF program. This proportion has decreased substantially since then, partially because of the decreasing presence of IMF-supported programs in LAC. There are, nevertheless, instances where IDB has continued to support policy-based operations in the context of an IMF program, including operations for Argentina, Ecuador, and Jamaica in recent years.

III. INSIGHTS FROM EVALUATIONS OF POLICY-BASED LENDING IN OTHER MDBS

3.1 **This section discusses key findings and cross-cutting issues from other MDBs' evaluations of policy-based lending presented at a conference organized by the Asian Development Bank (ADB) in 2020.** The conference gathered the evaluation units of some major MDBs to present evidence on the design, use, and performance of policy-based lending over the past decade. A report based on that conference will be published soon (ADB, 2023). This section summarizes some of the central insights of that report, based on the evaluations of the policy-based lending instrument carried out by the evaluation offices of the World Bank, the ADB, and the African Development Bank (AfDB).[6][7]

3.2 **The analysis of these findings shows that policy-based operations are remarkably similar in all MDBs.** Practically all MDBs have a policy-based lending category to support developing finance needs and policy and institutional reforms in a particular sector or the whole economy (see Box 3.1). Policy-based funding is not tied to specific goods, works, or budget items. The loan size is primarily related to financing needs, not the cost of the supported reforms. Moreover, all MDBs place an implicit or explicit cap on this category to avoid crowding out investment lending.

6 These three MDBs, together with the IDB and the European Bank for Reconstruction and Development (EBRD) are called "Legacy Banks". In 1996, the evaluation units of these five major MDBs established the Evaluation Cooperation Group (ECG) to promote a more harmonized approach to evaluation methodology at MDBs.

7 For the ADB, the report draws on an evaluation of policy-based lending carried out by the ADB Independent Evaluation Department in 2018 (IED, 2018). For the AfDB the report draws on two evaluations of the Independent Development Evaluation Department covering the 1999–2009 period (OPEV, 2011) and the 2012–2017 period (IDEV, 2018). At the World Bank, the Independent Evaluation Group (IEG) has not done a recent comprehensive evaluation of the instrument, but its report draws on its repository of Policy-based lending performance ratings, thematic evaluations, and learning products, as well as World Bank's policy-based operation retrospectives, prepared by World Bank's Management.

Box 3.1 Policy Based Modalities in the AfDB, ADB, and World Bank

The AfDB has four modalities of Program-Based Operations (PBO, its denomination for policy-based lending): i) General budget support, supporting policy and institutional reforms that are established in the country's national development plan; ii) Sector budget support, similar to the previous but focused on a particular sector (although financial transfers go through the national budget too); iii) Crisis response budget support, which is a fast-disbursing loan or grant to mitigate the adverse impact of political, economic, or humanitarian crisis or shocks; iv) Import support, used only exceptionally and involving the transfer of financial resources to the Central Bank to boost reserves in the case of a balance of payment deficit. According to its policies, AfDB budget support can be provided by stand-alone operations (single disbursement); programmatic operations (a series of single-year operations in a multi-year framework); and programmatic tranching (single loan operations with a series of tranches set upfront).

At the ADB, policy-based operations were gradually modified to replace stand-alone modalities with programmatic series. While the stand-alone was usually arranged in tranches with release conditions specified up front, programmatic policy-based operations consist of a series of distinct loans (subprograms) supporting sequenced reforms and connected by a common results framework. Ex-ante conditions have been gradually substituted by prior actions or policy changes made before loan approval. The ADB has two additional policy-based lending modalities that are crisis-response instruments: the Counter-Cyclical Support Facility (CSF) and special PBL (SPBL). CSF helps finance a fiscal stimulus following a crisis, while SPBL supports a country during a balance of payments crisis. Besides these policy-based operation types, ADB also uses policy-based lending as a precautionary instrument in case an economic or disaster-related crisis may occur, where policy reforms are related to reducing risks.

The World Bank has also pivoted from standalone single or multi-tranche policy-based operations (Development Policy Financing, DPF) towards an approach that provides all the funding up-front, upon completion of prior actions. Implementing all prior actions is a condition for approval by the Board of Executive Directors. While stand-alone loans may be more appropriate for short-term needs or situations of uncertainty, programmatic operations are preferred at the World Bank because they can support longer-term reforms more consistently, particularly in a stable policy environment. In exceptional cases, the World Bank may provide a separate supplemental DPF additional to the original operation if an unanticipated gap in financing jeopardizes a reform program. Additionally, the World Bank offers a DPF for debt and debt service reduction, which helps highly indebted countries reduce commercial debt and debt service to a manageable level, as part of a medium-term financing plan in support of sustainable growth.

Source: OVE based on ADB 2022.

3.3 **Evaluating policy-based operations is far more challenging than assessing conventional investment projects.** The report states that investment loans benefit from more clarity of measurement metrics and greater data availability. By contrast, metrics for policy-based operations are not well established and are more difficult to standardize across sectors and countries. Another common difficulty in evaluating policy-based operations concerns attributing country outcomes to using them, including the policy actions they support and the fast-disbursing financial support they provide.

3.4 **MDB's evaluations of policy-based operations follow an objectives-based methodology**. MDBs typically evaluate policy-based operations performance against its set objectives, usually defined at entry in the results matrix. Evaluations usually examine the relevance and effectiveness of policy actions and measures implemented under the program. This approach is built on qualitative and quantitative evidence on the inputs, outputs, and outcomes delivered through specified actions or policy interventions.

3.5 **The report establishes that across MDBs, policy-based operations are generally associated with satisfactory evaluation scores of project completion reports, with some caveats.** Although policy-based operations performance ratings have varied across country recipients and providing institutions, it has improved over time thanks to adjustments in operational design among MDBs. Currently, a majority of policy-based operations are rated partly satisfactory or more across MDBs. The gradual substitution of multi-tranche operations for programmatic series has contributed to overcoming implementation problems such as delays in the disbursement of the final tranches of an operation. However, attribution of results to the instrument is not straightforward because loans in PBPs' series usually reward prior actions instead of future commitments. A further general limitation is that no attempt was made to evaluate the impact of policy-based operations on economic growth and poverty reduction.

3.6 **According to the report, operational design influences policy-based operations performance scores in all MDBs.** At the ADB, the evaluation finds that positive development outcomes are more likely if the policy-based operation design is robust. At the AfDB, the most often cited enabling factor is also the design quality of the project. Regarding hindering performance, the most often cited factors at the AfDB are insufficient policy dialogue, high transaction costs, poor choice of indicators, weak monitoring, and poor predictability. At the World Bank, empirical findings show that improving the relevance of design, including emphasizing the congruence between policies supported and development objectives pursued, is critical for achieving better policy-based operations outcomes. There is also evidence that the performance scores of policy-based operations at the World Bank are positively affected by sound analytical underpinnings, robust macro policies, and strong government ownership.

3.7 **The evaluations elaborate to what extent policy-based lending encourages policy reform vis-à-vis just responding to countries' financial requirements.** Due to economic growth and better access to international markets, the average size of a policy-based operation relative to a country's GDP has declined substantially across MDBs. Hence, the evaluations generally conclude that the capacity of policy-based lending to act as an incentive for policy reform has diminished. The ADB's evaluation shows that policy-based operation sizes (as a percentage of GDP) are positively correlated with the dimension of fiscal deficits and negatively correlated with GDP growth. According to the ADB's evaluation office, this finding suggests that providing predictable and reliable financing can be seen as the primary objective of the instrument at the ADB rather than policy reform, even though the latter is, in theory, the program's primary motivation. On the other hand, the AfDB evaluation finds that the overall picture is satisfactory regarding achieving reform objectives with the instrument. However, finding evidence of AfDB's influence on reform direction and speed is more complicated. At the World Bank, policy-based lending is, theoretically, a flexible instrument that can both support long-term reforms and provide liquidity for short-term goals. In reality, policy frameworks primarily focus on timely budget financing during market unrest because operations focus mainly on anti-crisis fiscal management. Because of that counter-cyclical focus, policy frameworks at the World Bank included comparatively few structural measures, according to the evaluation.

3.8 **The evaluations find that providing liquidity alone cannot achieve policy reform.** For MDBs to be effective in policy support, the programs must be complemented with other instruments beyond budget support, including policy diagnostics and technical assistance (TA). The ADB's evaluation notices that policy-based operation design and implementation were widely supported by grant-financed TA, which undertook analysis and supported the implementation of policy actions before the loan approval. However, slow delivery and underuse of

TA sometimes undermined operational effectiveness. At the AfDB, policy-based operations are expected to form part of a "package of support" to influence and ensure reform agendas while providing critical funding. This package includes analytical work, policy dialogue, and capacity support, but AfDB's evaluation reveals that the Bank had underperformed regarding policy dialogue. It also found negative perceptions of TA's efficiency, transaction costs, or institutional support provided to support policy-based operations. As a result, according to the evaluation, the AfDB underperforms in delivering timely and enough capacity support and expert TA. These shortcomings affect how well AfDB influenced or added value to country reform paths. According to the World Bank, the prior actions required for policy-based operations disbursement alone are not often enough to achieve the program objectives. Additional efforts by governments and complementary support from investment projects and development partners are usually needed.

3.9 **All evaluations find that the volume of policy-based operations and their share in total lending increased sharply during and right after crises (2008–10, 2015–16, 2020–21)**. Policy-based lending approached (and sometimes exceeded) 30% of MDBs' total lending during those periods. While the COVID-19 pandemic response is outside the report's scope, it describes the recent evolution of policy-based operations approvals. At the ADB, there was a sharp increase in policy-based lending use during the pandemic, breaking the 20% ceiling imposed on this type of lending. This breach was only possible by introducing reform-free and fast disbursing budget-support modalities to finance borrowers' counter-cyclical public expenditure programs to mitigate the extent of the crisis. The AfDB intensified the use of the Crisis Response Budget Support (CRBS) program during COVID to respond quickly to the crisis.[8] CRBS is a fast-disbursing loan (or grant) to mitigate the adverse impact of an emergency where there is limited scope for policy dialogue. Still, the instrument can be used to open the door for future policy dialogue. According to IEG, at the World Bank, in the last 15 years, policy-based operations have typically accounted for between one-fourth and one-third of total International Bank of Reconstruction and Development (IBRD) plus International Development Association (IDA) commitments, rising to as high as 40% during major crises. During the COVID-19 pandemic (April 2020 - June 2021), policy-based lending amounted to US$28 billion, a substantial increase from US$13 billion in Fiscal Year 2019.

3.10 **According to the report, the three MDBs evaluated strongly count on the IMF for macroeconomic assessments.** The ADB's evaluation observes that the Bank relies too much on the IMF for policy-based operations approval. Consequently, the evaluation recommended that the Bank assess the risks involved independently when an internal position on a country's macroeconomic situation diverges from the IMF's.[9] According to its evaluation, AfDB's approach has aligned with the G20 Principles for Effective Coordination between the IMF and MDBs on policy-based lending, which proposed that all MDBs align behind the IMF regarding

8 The AfDB faced a similar major emergency in 2014 due to the Ebola crisis affecting some members. At that time, the Bank also used the policy-based lending instrument to strengthen the countries' health systems so that they could tackle the outbreak.

9 On that recommendation, ADB's Management clarified that there were only two (out of 181) cases of divergent views on borrowing countries' macroeconomic conditions. According to the report, ADB has since strengthened the capacity of the Strategy, Policy, and Partnerships Department to oversee policy-based operation design prior to Board approval.

countries facing macroeconomic vulnerability. At the World Bank, policy-based operations require an adequate macroeconomic framework, as determined by the staff, with inputs from IMF assessments. An independent reassessment of the quality of World Bank macro-fiscal frameworks in policy-based operations finds a strong alignment between the analytical work of the two institutions.

3.11 **The evaluations find that all MDBs concentrate their policy-based operations in countries with relatively higher income levels and institutional capacity.** Middle-income countries (MICs) have consistently made the greatest use of policy-based lending, relying on them as a source of budget financing even in non-crisis years. ADB's evaluation found that policy-based lending is primarily used by larger, more capable, and more developed countries. At the AfDB, over 75% (by amount) of policy-based lending approved since 2012 have been for operations in MICs, translating to about one-third of the number of operations. Equally, the World Bank has historically made relatively more significant use of policy-based lending in MICs than in low-income countries (LICs). According to the evaluation, this trend reflects the more advanced institutional and absorptive capacities and better-developed systems of public expenditure management and budget planning in MICs.

3.12 **Finally, evaluations find a general trend in policy-based lending to support less critical reforms.** According to the report, policy-based lending in all MDBs has moved over time from more politically sensitive reforms to more specialized ones generally connected with public finance management (PFM). Currently, programmatic policy-based lending is often focused on budget formulation, execution, and audit and is less focused on expanding infrastructure or eliminating significant constraints to growth.[10] This trend provokes an improvement in policy-based operations evaluation scores in project completion reports, as policy actions are within the direct control of finance ministries, which are the primary stakeholder in the policy-based operation design.

IV. EVOLUTION OF POLICY-BASED LENDING PORTFOLIO

A. Distribution by type of policy-based operation

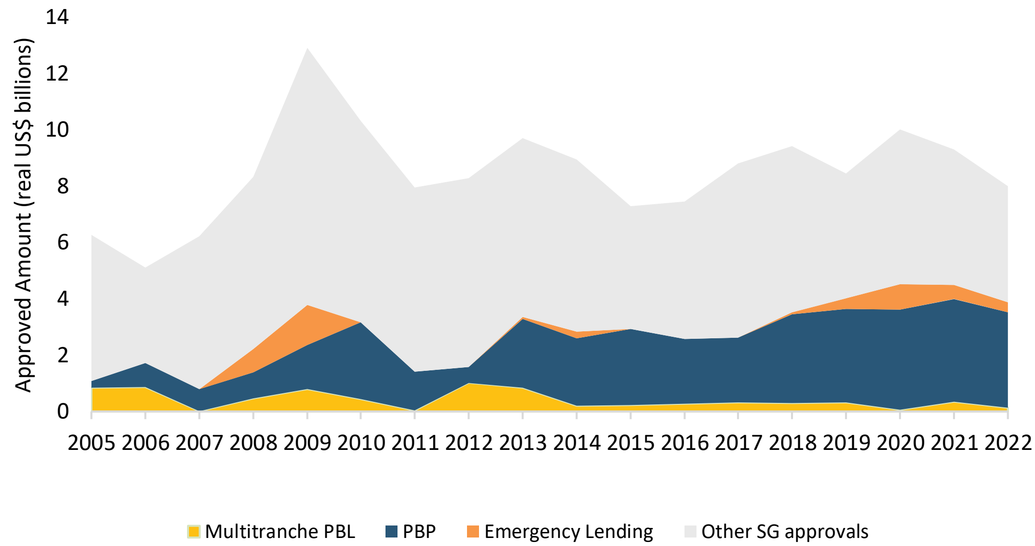
4.1 **Since the inception of PBPs in 2005, policy-based lending has accounted for 31.1% of SG approvals,[11] with the share increasing over time.** In this period, IDB approved 332 policy-based operations totaling US$59.7 billion. About 83% of these resources were approved as PBPs (including 6.5% for PBPs with DDO) supporting 159 programs. Of the US$59.7 billion, 15.1% was approved as multi-tranche PBLs and 1.9% as policy-based guarantees. Since 2014, PBPs have accounted for more than 85% of all approved policy-based operations. Policy-based lending's share of total SG approvals (including emergency lending) increased from 19% in 2005–2009 to 27% in 2010-2014, 37% in 2015–2019, and 42% in 2020-2022 (see Table

[10] At the ADB, nearly two-thirds (by value) and more than one-half (by number) of policy-based operations approved since 2008 supported public sector management reforms. At the AfDB, almost two-thirds of policy-based operations approved between 2012-2017 were listed as General Budget Support, which typically concentrates on core economic governance areas such as PFM. At the World Bank, thematic evaluations also show the predominance of prior actions related to PFM within policy-based operations.

[11] Sovereign guaranteed approvals in this context includes all SG loan and guarantee operations regardless of funding source.

4.1 and Figure 4.1). The 2007–2009 global financial crisis led to a significant increase in the number and amounts of policy-based operations. IDB approved 61 policy-based operations for US$7.8 billion in 2008–2010, compared with only 31 such operations for US$3.8 billion during the previous three years. After falling somewhat in relative importance in 2011–2012, policy-based operations rose again in 2013 and since then IDB has averaged around 20 policy-based operations totaling US$4.4 billion per year (see Figure 4.1).

Figure 4.1. Evolution of Policy-Based Lending, 2005–2022



Source: OVE, based on data from IDB databases.

4.2 **Emergency lending accounted for 3.1% of SG approvals between 2005 and 2022.** Emergency lending to provide financial support during a macroeconomic crisis was primarily used during the 2007–2009 financial crisis and later during the COVID-19 pandemic. Overall, IDB approved US$6 billion in emergency lending between 2005–2022, of which 59% was approved in 2008-2009 through EME operations and 33% in 2020-2021 through SDLs.

4.3 **IDB's policy-based and emergency lending spiked in recent years, in response to the COVID-19 pandemic and its economic effects (see Boxes 4.1 and 4.2).** To facilitate timely approval of operations to help its borrowing member countries respond to the COVID-19 pandemic and related social and economic effects, IDB developed several prototype operations, including one for a policy-based operation supporting fiscal and economic management to help cushion the effects of the economic crisis. The policy-based prototype sets out a menu of policy measures geared towards the timely availability of resources to respond to the public health crisis, temporary expansion of social protection programs, provision of essential services, efficient public expenditure management, and formulation of a program for economic recovery. Individual operations then draw on a menu of these measures for speedy preparation and approval. The prototype also includes a pro forma results matrix. From 2020 to 2022, IDB approved 24 policy-based operations for US$6.8 billion, of which US$1.2 billion went to five prototype operations. In addition, it approved five SDLs for US$1.2 billion.

Box 4.1. Policy-based lending and the IDB Response to the COVID-19 Pandemic

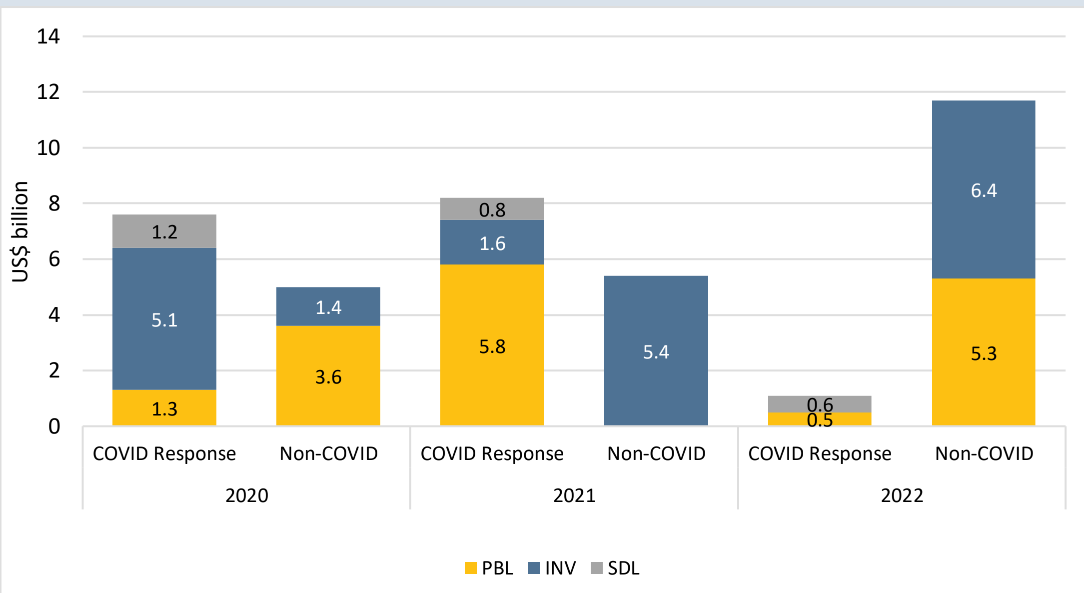
Policy-based lending was a central element of IDB's COVID response (documents GN-2995 and GN-2996). The Bank considered this instrument as the most suitable to cover public expenditure and respond to increasing financing needs with large volumes of fast disbursing resources. Management designed templates for draft project proposals (called prototypes) in four priority areas (Immediate Public Health Response, Safety Nets for Vulnerable Populations, Economic Productivity and Employment, and Fiscal Policies for the Amelioration of Economic Impacts) to facilitate a faster approval process and to provide funding to borrowers without much delay.[a] The prototype included programs to strengthen public policy and fiscal management to address the health and economic crisis.

Considering the anticipated increase in the use of this instrument, the policy- based lending cap was increased to 40%.[b] In addition, approval rules were relaxed to use a no-objection procedure (instead of formal voting) by the Board of Executive Directors.

Nine policy-based prototype operations were approved during 2020-2021 for US$1.5 billion (30% of total policy-based lending). All policy-based prototype operations were in C&D countries.[c] Most of these prototype operations (seven) were approved in 2020, when policy-based prototypes represented 17% of IDB's operational response (US$7.6 billion).[d] Two additional policy-based prototype operations were approved in 2021, including a second operation for the programmatic series approved for Uruguay the previous year.

By 2021, it was understood that all liquidity provided to countries was part of the response to the effects of the pandemic. Policy-based lending represented most of the IDB's operational response to the COVID-19 pandemic during that year, representing 71% of the COVID response and 43% of total approvals. In 2022 only the continuation of the three programmatic series approved in GY, JA, and PR were counted as COVID response.

Approvals 2020-2022 by Type of Instrument and response to the COVID-19 Pandemic



Sources: IDB COVID-19 Dashboard and IDB's Annual Business Reviews.

Notes: [a] The four priority areas were: The Immediate Public Health Response, Safety Nets for Vulnerable Populations, Economic Productivity and Employment, and Fiscal Policies for the Amelioration of Economic Impacts. https://www.iadb.org/en/news/idb-group-announces-priority-support-areas-countries-affected-covid-19. Prototypes of PBL were designed exclusively for the area of Fiscal Policies.

[b] In resolution AG 8/20 (2020), Governors resolve: "That the limit of thirty percent (30%) set forth in paragraphs 3 and 4 of resolution AG-9/11, be increased to forty percent (40%) for approvals of Policy-Based Loans to be financed with the Bank's Ordinary Capital resources and Concessional OC resources until December 31, 2022."

[c] The Bahamas, Dominican Republic, El Salvador, Guyana, Jamaica, Paraguay, Trinidad Tobago, and Uruguay (two operations).

[d] The IDB published a dashboard with information on all the projects included in the operational response to the pandemic.

Box 4.2. Common early findings on PBL during COVID-19

ICPRs completed during 2022 for Chile, Ecuador, Guyana, Jamaica, and Peru found increased approvals and disbursements from policy-based lending in response to the pandemic in all countries except Jamaica, while at the same time implementation challenges for INV persisted or increased:

Chile canceled investment operations that exhibited low levels of disbursement and faced budget restrictions, making intense use of policy-based lending, together with technical assistance and policy dialogue with the Bank, freeing up financing space to meet the temporary needs raised by social unrest and the pandemic. Limitations in the fiscal space of the line ministries and the lack of budgetary additionality of INV were considered a risk for implementation because they reduce the incentive for their execution.

In **Ecuador**, the IDB program adapted to the pandemic context, proactively approving a diverse and complementary mix of instruments to adjust to country needs with an increased share of fast-disbursing operations - associated with the pandemic response, with policy-based lending, SDLs, and Contingent Credit Facility (CCF) being defined as fast-disbursing loans for the review. The implementation problems for INV intensified due to fiscal constraints and multiple barriers that increased in the wake of the pandemic such as lack of capacity and high turnover of execution units.

In **Guyana**, more than two-thirds of SG loan approvals for the period were for COVID-19 response operations, comprising one policy-based operation and two INVs, with a total increase in disbursements compared with the previous period based on these operations. While policy-based lending represented a larger share of loan approvals compared with the previous period, SG loan approvals in the Country Strategy (CS) period were mostly concentrated in INV. Project execution and disbursements for INV were lower than expected. Persistent challenges of low execution capacity and procurement processes were the main factors that affected the implementation of investment loans.

In **Jamaica**, two IDB prototype policy-based operations were approved in 2021 and 2022 to address the pandemic as the Bank's SG lending continued to be skewed toward policy-based operations (since 2016 more than half of the country portfolio has been channeled through policy-based lending). One of this policy-based operations was focused on supporting the short-term response to the pandemic, while the other included conditions to review spending of programs related to the health emergency and to promote economic and fiscal recovery in the medium term. No new SG investment loans were approved after 2020, given the limited availability of fiscal space for INVs (tighter amid the pandemic) and the country's proactive debt-management stance. The main challenges for implementing investment projects were the tight fiscal space, the limited institutional capacity of project executing units, complex procurement processes, and low coordination among key stakeholders, which sometimes intensified in the wake of the 2020 crisis.

In **Peru,** with the arrival of COVID-19, the Bank's support was concentrated on fast-disbursing loans, comprising four deferred policy-based operations disbursed between April 2020 and May 2022. SG loan disbursements far exceeded the CS estimate and doubled compared to the previous period. This was mainly due to the growth of the policy-based lending portfolio and their respective disbursements in response to the COVID-19 crisis. Administrative rotation in the ministries and high authorities and the lack of capacity for execution stood out as implementation problems for INVs, deepened by the arrival of COVID-19.

Source: OVE, 2023 (document RE-576).

B. Distribution by country

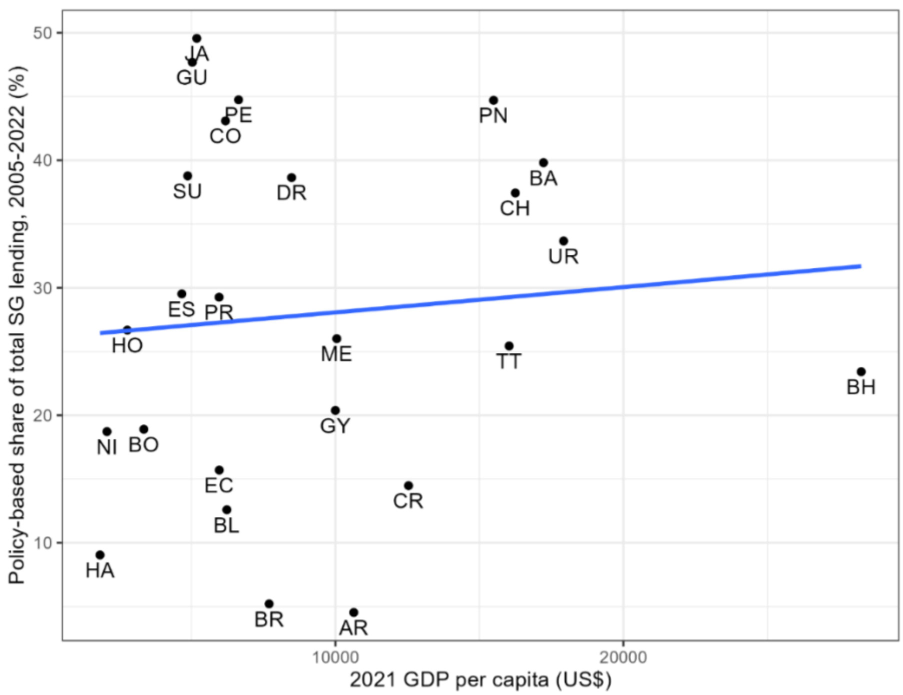
4.4 **All borrowing member countries, except for Venezuela, made use of policy-based lending between 2005–2022, but its relative importance in country portfolios varied.** The share of policy-based lending in overall SG approvals increased for all IDB country income groups during the period. In terms of overall importance, a few countries have dominated in the number and dollar amounts of policy-based operations received. Historically, more policy-based operations have been approved for C&D countries[12] (see IDB, 2022). Nonetheless, A&B countries[13] had a higher share of policy-based lending amounts. For example, Peru received

[12] Bahamas, Barbados, Belize, Bolivia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Nicaragua, Panama, Paraguay, Suriname, Trinidad & Tobago, and Uruguay.

[13] Argentina, Brazil, Chile, Colombia, Mexico, and Peru. Venezuela is the only country that did not use policy-based lending between 2005-2022.

40 policy-based operations and Colombia 31, reflecting their strong preference for the instrument. In terms of volume, Colombia and Mexico together accounted for 36% of the approved policy-based lending amounts over this period (see Table 4.1). Between 2010 and 2022, Jamaica and Colombia had 50% of their lending program approved through policy-based operations. Eight countries (Chile, Colombia, Dominican Republic, El Salvador, Jamaica, Mexico, Panama, and Uruguay) borrowed at least half of their SG envelope in the form of policy-based lending in the 2015–2019 period. Since the onset of the pandemic in 2020 the use of policy-based lending has further increased. In the 2020-2022 period 18 countries had at least 37% of their approvals in the form policy-based operations (only Argentina, Brazil and El Salvador used policy-based lending in a more limited manner)[14]. All C&D countries that were eligible during the 2020-22 period made use of policy-based lending except for Belize (see document GN-3079). Only two countries (Peru and Uruguay) have made use of the DDO, with Uruguay using it as an important instrument for fiscal and foreign exchange management (approvals comprised US$300 million in the last two years in the case of Uruguay and US$ 900 million in the case of Peru).

Figure 4.2. GDP Per Capita and Share of Policy-Based Lending by Country, 2005–2022



Source: OVE, based on data from IDB databases.
Note: AR=Argentina; BH=Bahamas; BA=Barbados; BL=Belize; BO=Bolivia; BR=Brazil; CH=Chile; CO=Colombia; CR=Costa Rica; DR=Dominican Republic; EC=Ecuador; ES=El Salvador; GU=Guatemala; GY=Guyana; HA=Haiti; HO=Honduras; JA=Jamaica; ME=Mexico; NI=Nicaragua; PN=Panama; PR=Paraguay; PE=Peru; SU=Suriname; TT=Trinidad and Tobago; UR=Uruguay.

14 Policy-based lending was not available to countries that lacked an IAMC.

Table 4.1. Policy-Based Lending Approvals by Country, 2005–2022

Country	Number of Approvals				Total Amount (US$ million)				Lending as a % of SG Approvals			
	2005-2009	2010-2014	2015-2019	2020-2022	2005-2009	2010-2014	2015-2019	2020-2022	2005-2009	2010-2014	2015-2019	2020-2022
Argentina	1		5	1	500		1,200	500	6%		15%	10%
Bahamas		1		3		48		540		19%		79%
Barbados		2		5		115		500		51%		91%
Belize	2				40				52%			
Bolivia	1	6	8		15	402	844		3%	27%	35%	
Brazil	1	6		1	409	1,834		208	6%	16%		4%
Chile		1	8	6		10	705	1,300		5%	65%	61%
Colombia	7	9	9	6	1,750	2,270	3,900	2,468	43%	61%	76%	77%
Costa Rica			1	3			350	780			34%	50%
Dominican Republic	2	5	4	3	210	1,060	1,250	700	17%	49%	59%	40%
Ecuador	1		3	6	50		900	1,615	4%		26%	48%
El Salvador	3	3	2	1	500	500	550	250	45%	37%	65%	18%
Guatemala	4	3	1	1	800	734	250	300	60%	89%	35%	45%
Guyana	5	2	2	2	55	22	29	164	25%	11%	30%	39%
Haiti	5	8	1		100	176	27		18%	15%	3%	
Honduras	2	5	8	3	58	296	459	425	13%	27%	38%	51%
Jamaica	3	10	6	3	120	850	465	275	22%	72%	60%	100%
Mexico	3	4	7	4	1,200	3,000	4,250	2,700	18%	31%	51%	70%
Nicaragua	3	5	3		91	223	195		17%	25%	23%	
Panama	2	6	9	4	200	1,250	1,750	650	15%	76%	54%	37%
Paraguay	2	1	4	5	130	100	790	1,000	20%	10%	37%	58%
Peru	11	21	4	4	1,155	670	750	1,800	60%	47%	38%	69%
Suriname		9	1	1		255	70	150		62%	23%	43%
Trinidad and Tobago		5		1		335		100		35%		39%
Uruguay	4	2	4	3	660	670	997	650	52%	39%	54%	51%
Total	**62**	**114**	**90**	**66**	**8,042**	**14,819**	**19,731**	**17,075**	**19%**	**27%**	**37%**	**42%**

Source: OVE, based on data from IDB databases.
Note: Includes PBL funding from all sources, not just IDB Ordinary Capital and Fund for Special Operations.

C. Distribution by sector

4.5 **Policy-based loans in public sector governance and economic management have dominated in the 2005-2022 period.** To analyze the sector distribution of policy-based lending OVE grouped IDB sector classification into six thematic areas: (i) public sector governance and economic management; (ii) financial sector reform and private sector development (with the latter mostly supporting measures to improve competitiveness); (iii) social sectors (health, education, social protection, and gender); (iv) infrastructure and utilities (transport, energy, water and sanitation, housing and municipal infrastructure); (v) environment, natural resource, territorial and disaster risk management, and agriculture, and (vi) other (industry, regional integration and other). Both in terms of the number of operations (32.1% of the total) and approval volumes (37.3% of the total), policy-based lending in public sector governance and economic management has dominated in the period 2005-2022.[15] The importance of reforms supported in this area grew considerably with the 2007–2009 global financial crisis (see paragraph 3.2). However, OVE (2015a) found that the content of policy conditions did not change much compared with similar operations approved before the crisis. Programs initiated in pre-crisis years (2005–2007) and crisis years (2008–2010) included similar conditions, which were usually oriented toward such areas as establishing fiscal rules, increasing government revenues, or improving spending, and developing frameworks and systematic macroeconomic forecasting for budgeting.[16]

4.6 **Since 2010 the use of policy-based lending has become more diverse and it is now being used in other sectors.** The second most important area supported by policy-based lending is infrastructure, with a particular focus on utility reforms, which accounted for 22% of operations and 16.5% of lending volume (see Figure 3.3). This group grew considerably in importance over the review period, from only 10 operations approved in 2005–2009 to 27 operations in 2015–2019 (and 10 operations in the shorter 2020-22 period) driven by support for energy sector reforms. During the recent COVID-19 pandemic policy-based operations were approved for public sector governance and economic management and the social sector.

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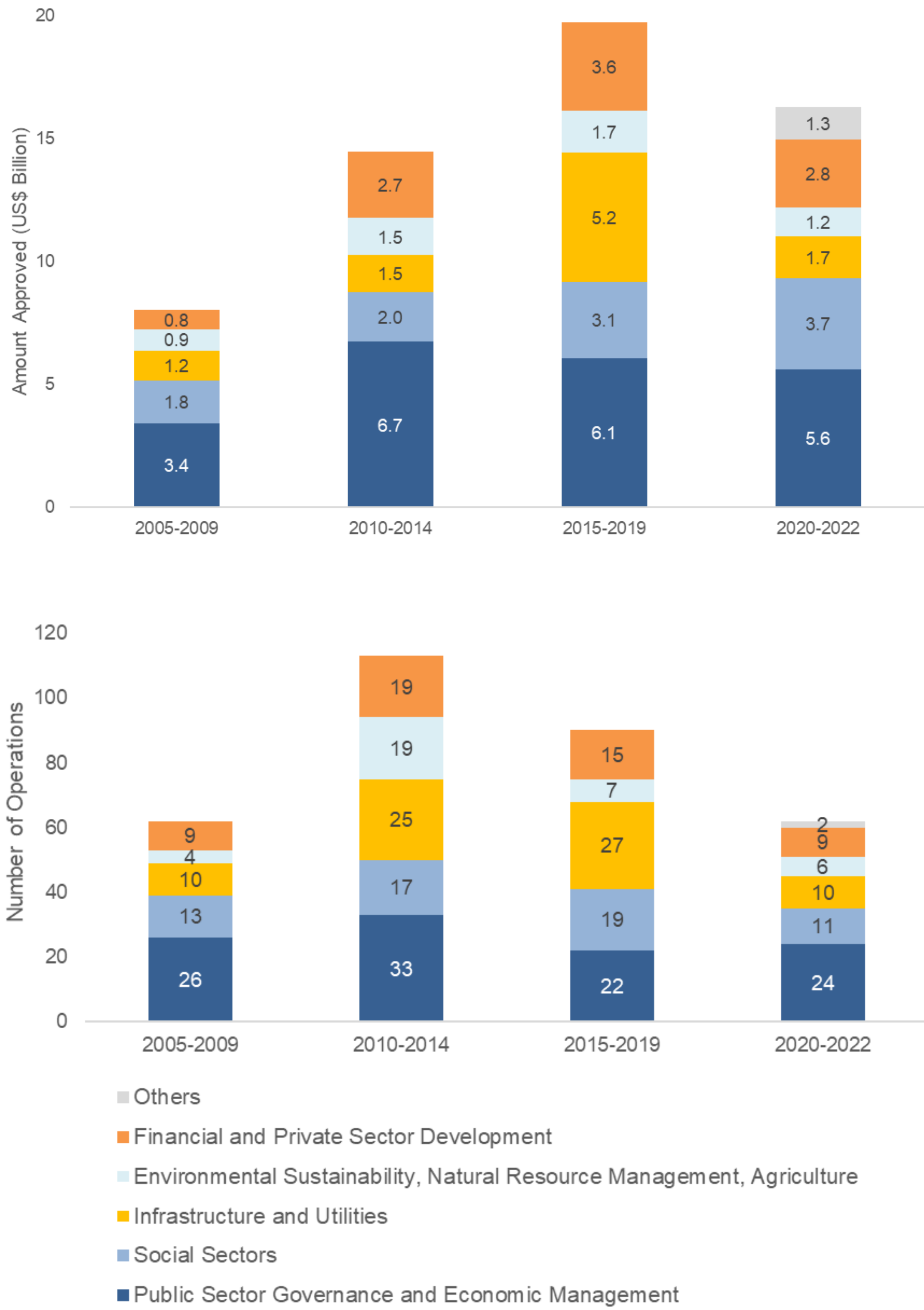
15 Some policy-based operations support reforms in multiple sectors. When assigning a sector code to an operation, IDB goes by the number of policy measures in each sector and does not account for the fact that operations may cover several sectors. Hence the figures presented here may not give a full picture of all reforms supported in each area.

16 OVE, 2015a (document RE-485-6).

Figure 4.3. Distribution of policy-based operations by Focus Area, 2005–2022
(first graph shows approved amounts in US$ billion; second graph shows number of operations)



Source: OVE, based on data from IDB database.

V. DEMAND DRIVERS AND DEPTH ANALYSIS OF POLICY CONDITIONS

A. Demand drivers for policy-based lending

5.1 **From the findings of OVE's 2015 Policy-Based Lending note as well as evidence from CPE, ICPR, XCPE, the 2020 Lending Instruments report (document RE-549), and the 2022 Annual Report (document RE-576), OVE has identified five, not mutually exclusive, drivers of demand for policy-based lending across its client countries:**

a. **Budget support.** Some countries use policy-based lending in a countercyclical fashion (for example, to deal with a crisis that had suddenly halted capital inflows) or as a swift source of liquidity to handle short-term needs, such as debt servicing. OVE's 2015 note on policy-based lending found that countries like the Dominican Republic, Honduras, and Jamaica exhibited a negative correlation between policy-based lending and GDP growth rates, and a positive correlation between policy-based lending and fiscal deficits or gross financing requirements, had relatively high rates of programmatic series interruptions, did not rely much on parallel IDB technical cooperation grants to accompany the reform programs and, since their demand for policy-based lending depended on economic needs, were not among the most regular users of the lending category. In recent years the demand drivers for Jamaica and Honduras have been more mixed (see bullet d in this paragraph), but the XCPE for the Dominican Republic, 2013-2020 (document RE-566) confirmed these previous findings. The Dominican Republic lending program was predominantly comprised of PBP series, of which only one third were completed. As series were truncated in one sector, a new series was approved in another sector. Half of the PBP series were not planned (included in the Country Programming Documents). Also, technical cooperation grants provided greater support for the INV program than for policy-based program.

b. **Debt and liquidity management.** OVE country program evaluations (CPE) suggest that some countries with ample access to international financial markets and capacity to issue bonds at competitive interest rates tend to use policy-based lending as a debt and liquidity management tool to complement market financing. The CPE Colombia 2015-2018 (document RE-529-3), for example, found that, as the country gained increased access to financial markets, policy-based lending remained attractive because its fast, large, and predictable disbursements facilitated the Ministry of Finance's financial planning. Similarly, CPE Mexico 2013-2018 (document RE-536-1) found that the Ministry of Finance sought regular and predictable disbursements for debt management purposes.[17] The CPE Uruguay 2016-2020 (document RE-546-1) found that the Bank continued to support Uruguay's precautionary borrowing strategy (see below) and played a key role as a counterpart, trusted advisor, and market link for the government in its liquidity and sovereign debt managing efforts, although the Country Strategy (CS) did not explicitly establish any strategic objectives to this effect.

c. **As seal of approval for reforms and to benefit from IDB's technical advice.** Some countries tended to resort regularly to policy-based lending to

[17] CPE: Colombia 2011-2014 (document RE-477-1); CPE: Colombia 2015-2018 (document RE-529-3); CPE: Mexico 2013-2018 (document RE-536-1).

help legitimize their policy reform process by getting a "seal of approval" from IDB and to benefit from technical discussions between country officials and IDB specialists. Their PBPs and PBLs tended to be relatively small, and the demand for them tended not to be correlated with growth, fiscal deficits, or gross financing requirements. Moreover, PBP series in these countries had low truncation rates (a reflection of reform program implementation over a more extended period and arguably higher ownership of the underlying reform program). They relied significantly on parallel technical cooperation grants provided by IDB to support the loans and considered the Bank a fiduciary partner. OVE (2015a) studied the correlation between parallel Technical Cooperations (TCs) and the completion of 82 PBP series, the total dollar amount approved in technical assistance, and the number of TCs. An example of this group is Peru, which is the most regular user of policy-based lending to legitimize institutional reforms and obtain technical expertise through strong parallel TCs. It had 40 PBPs approved between 2005 and 2022 arranged in 17 programmatic series, with each loan of relatively small size and all of them completed (ICPR 2017-2021, document RE-569).

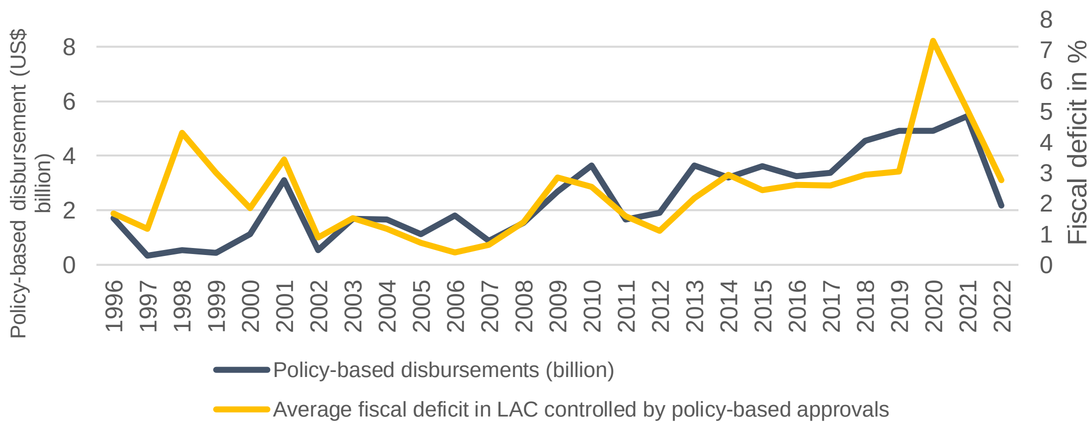
d. **Mixed.** Countries sometimes relied on policy-based lending to cover financing needs and to benefit from IDB's validation and/or technical inputs. Examples in the decade leading up to 2015 included Brazil, Colombia, Mexico, El Salvador, Nicaragua, and Panama. More recent examples include Chile (ICPR 2019–2022, document RE-570-1), Colombia (CPE 2015–2018, document RE-529-3), Jamaica (ICPR 2016–2022, document RE-573), Honduras (CPE 2015–2018, document RE-528-1, and ICPR 2019-2022, document RE-580), and Panama (CPE 2015–2019, document RE-547). In Jamaica and Honduras, for example, even though PBP series responded to financing needs and were aligned with IMF programs to support fiscal reforms, policy-based lending were complemented by INV and/or TCs to support the reform process with technical assistance and investment lending.

e. **Precautionary financing.** Uruguay has used policy-based lending as part of the government's precautionary borrowing strategy with MDBs. Since 2008, Uruguay has frequently postponed disbursements of approved PBPs and used the proceeds only when it faced large financing needs such as during the pandemic when it disbursed US$ 1.1 billion in PBPs and DDOs. This practice was institutionalized with IDB's introduction of the DDO modality in 2012. Peru is the other country that has also used this instrument (ICPR 2017–2021).

f. **Emergency response to the COVID-19 pandemic.** OVE's 2022 Annual Report (document RE-576) noted that COVID-19 triggered country program responses mainly through countercyclical fast-disbursing financial support, which is short in nature. With the pandemic, programs usually adapted by increasing financial support under the common provisional framework created by the Bank (e.g., COVID-19 prototypes, see Boxes 4.1 and 4.2).

5.2 **OVE's previous analysis suggests that a predominant driver of the demand for policy-based lending has been budget or debt financing.** OVE's review of recent CPEs, ICPRs and XCPEs in combination with results from OVE's note (2015a), suggests that despite the range of reasons for using policy-based lending across countries budget support is one of the most important reasons. While countries valued the policy dialogue and technical expertise that came with IDB policy-based lending, the policy elements were usually secondary to the primacy of budget support. Figure 5.1 shows that the fiscal deficit of countries that use policy-based lending is correlated with its disbursed amount. Drawing on the literature on early warning signals for economic and financial crises, OVE's 2015 note estimated fixed-effects panel regression models using policy-based operations disbursements as a percentage of GDP as the dependent variable. The results confirmed that countries' financing objectives were a key motivation for the use of policy-based lending, both to handle short-term financing needs and to face contingent shocks. A 2022 paper by the Office of Strategic Planning and Development Effectiveness (SPD) also finds evidence to support that policy-based lending provide support when countries face fiscal distress, and the IMF is present through an active program (IDB, 2022).

Figure 5.1. Link between policy-based operations disbursements and fiscal deficits

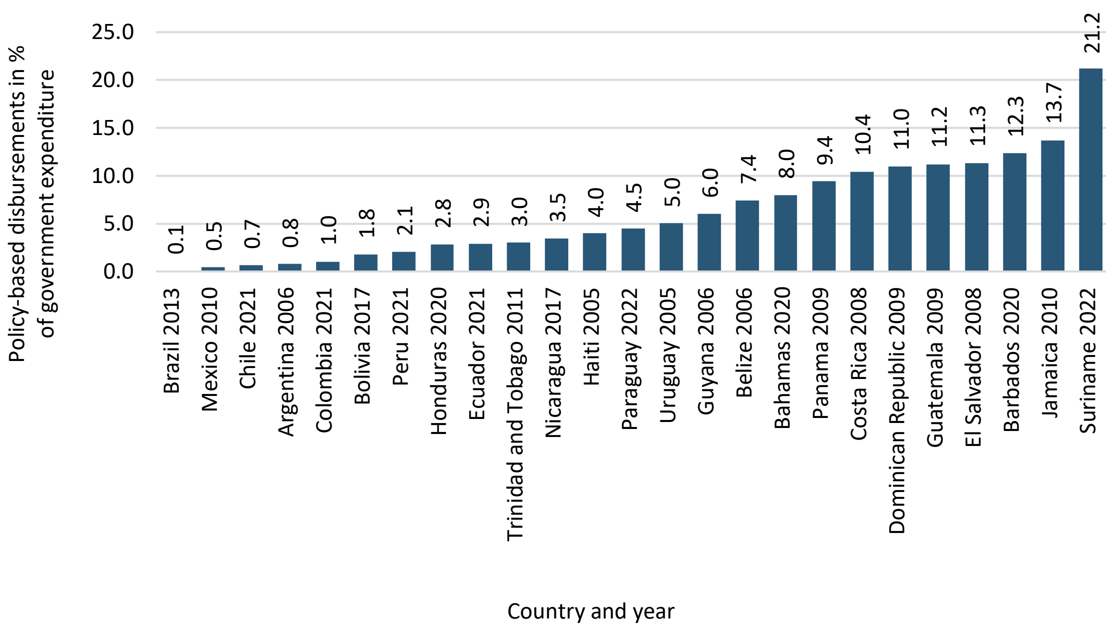


Source: OVE.
Note: Average fiscal deficits are only included for those countries that received approval for a policy-based operation in the respective year.

5.3 **Given the multiple drivers of demand for policy-based lending and IDB's dual objective of budget and reform processes support, many OVE CPEs have included recommendations for improving the mix of lending instruments and modalities to better respond to countries' needs and capacities**. As noted in OVE's review of lending instruments (OVE, 2020a), for example, the CPE for the Dominican Republic (2013-2016) recommended tailoring the supply of loan modalities to balance IDB support between (short-term) budgetary support and (long-term) support to CS development objectives. The CPE for Suriname (2011-2015) recommended adopting a more effective and complementary instrument mix that combines policy reform with technical support for implementation, ensuring the completion of the PBP series in progress. The CPE for Uruguay (2010-2015) recommended ensuring a better balance between contingent and investment lending. In addition, some CPEs included recommendations to improve the effectiveness of lending instruments, such as improving the structural depth of the PBP conditions and avoiding the truncation of series (Suriname CPE 2011-2015, document RE-493-1; Dominican Republic CPE 2013-2016, document RE-505-1; Guatemala CPE 2012-2016, document RE-503-1; Peru CPE 2012-2016, document RE-498-1; and Panama CPE 2010-2014, document RE-475-1).

5.4 **The use of policy-based lending for budget support purposes is particularly pertinent for small economies.** They tend to be more vulnerable to external economic shocks and IDB financing could be decisive in helping them to weather a storm (OVE, 2015a). While larger countries also made use of policy-based lending for fiscal, liquidity and debt management purposes, the instrument's ability to affect macroeconomic conditions in these countries is limited by the small size of the loans in relation to their overall economies. Figure 5.2 shows policy-based disbursements as share of government spending in the year in which the disbursements were the highest. For small economies like Barbados, Jamaica or Suriname policy-based funding can cover a significant portion of government expenditure (between 10-20% of government spending). The highest disbursements occurred around times of crisis such as the COVID-19 pandemic or the financial crisis of 2007-09 (see Figure 5.2). Conversely for large economies, including some that make extensive use of policy-based lending like Colombia or Mexico, it can at best play a marginal role in financing government expenditures (policy-based disbursements covered at a maximum of 0.5-1% of their government expenditures).

Figure 5.2. Share of Policy-based operations disbursements in % of government spending - Highest share by country 2005-2022



Source: OVE.
Note: Graph shows the highest share of policy-based operations disbursements for each country.

B. Depth of supported loan policy conditions

5.5 **To summarize the depth or criticality of the IDB loan policy conditions, this section draws on the analysis carried out in OVE (2015a) and OVE's country products delivered after 2015.** OVE (2015a) and OVE's CPEs, XCPEs, and ICPRs delivered after 2015 provide valuable insights into the content of policy reforms. In both cases, policy conditions were assessed according to the depth of the planned actions, i.e., their capabilities to trigger long-lasting policy and institutional changes (i.e., the criticality of the reform supported). Box 4.1 details the method used for the depth analysis. OVE (2015a) used a sample of programmatic loan operations approved between 2005–2014, representing half of all loans approved as part of a PBP series in that period. Country evaluation products delivered between 2015 and 2022 provide a depth analysis for 28 PBPs, representing about 31% of all loans approved as part of a PBP series in the 2015-2019 period. As the sampling strategy differs between the two sources, the results are not fully comparable.

Box 5.1. Methods used to assess depth of policy conditions

Policy conditions were assessed according to the depth of the planned actions, i.e. their capability to trigger long-lasting policy and institutional changes (i.e the criticality of the reform being supported), OVE's analysis reviewed the content of each policy condition and assigned one of three categories to it:

Low depth. Conditions that would not, by themselves, bring about any meaningful changes. Low-depth conditions are usually process-oriented and often involve the preparation of action plans or strategies and the announcement of intentions.

Medium depth. Conditions that can have an immediate but not a lasting impact. These include conditions calling for one-off measures that can be expected to have an immediate and possibly significant effect, but that would need to be followed by other measures for this to be lasting. Submission of draft legislation to Congress, reaching a target or benchmarks, and organizational changes are examples of medium-depth conditions.

High depth. Conditions that could, by themselves, trigger long-lasting changes in the institutional or policy environment. Conditions in this category include legislative changes, government decrees, or lower-level actions that complete a critical reform process. High-depth conditions also include measures that require that certain fiduciary measures be taken regularly or permanently, even when legislation is not needed.

This analysis was supplemented by an assessment of the programs' overall vertical logic and coherence. OVE evaluated the sequencing of the conditions across PBL tranches or across PBPs by looking at the extent to which the policy conditions included in each tranche of a multi-ranche PBL, or in each PBP, followed a logical sequence over time by supporting different stages of the reform process cycle (i.e., formulation or design, adoption or approval, implementation, monitoring and evaluation). OVE also assessed the program's vertical logic: the coherence between conditions and the reform program objectives. While OVE's analysis of the depth of policy conditions and their sequencing allowed it to gauge the progress of the reform program supported by a policy-based operation, the methodology did not measure IDB's technical additionality to the reform program or the extent to which the impetus for reforms could be traced to IDB actions.

5.6 **OVE (2015a) and recent OVE country products found that at least one-fifth of policy-based operations comprise mostly low-depth conditions.** In the 2015 OVE note, 20% of the policy-based operations had less than half of their policy conditions rated medium or high depth. In the 2015-2019 sample from OVE country products, 25% of the policy-based operations had less than half of their policy conditions rated medium or high depth (see Table 5.1). Because these samples are not comparable it is not possible to conclude on time trends. Low-depth conditions call for basic one-off measures or simply express reform intentions (OVE 2015a). For example, a condition would commit a line agency to an independent operational audit of a feeding subsidy or call on an agency to prepare terms of reference for the design of a methodology to analyze the outcomes of a national investment plan. It is questionable whether such measures align with IDB's guidelines, which stipulate that loan policy conditions should be essential for achieving expected results.

Table 5.1. Depth of policy conditions comparison between OVE (2015a) and 2015-19 sample based on OVE country products

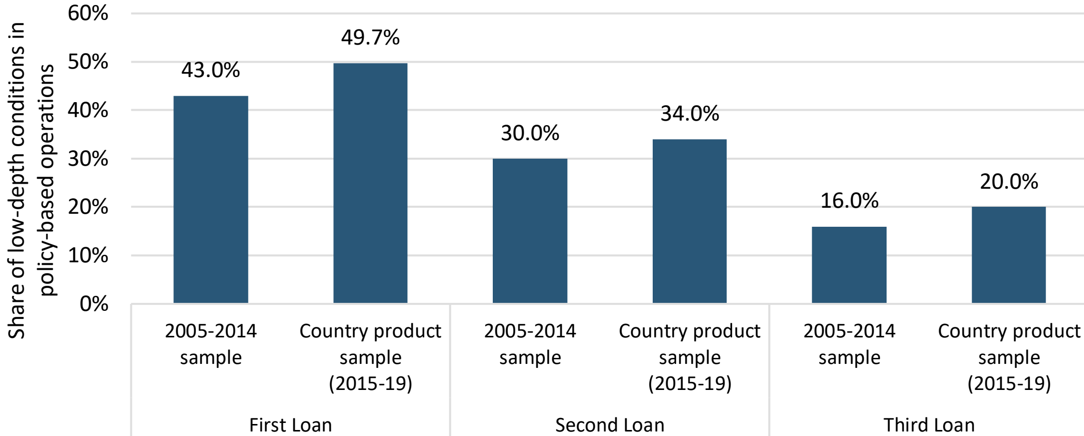
Share of medium and high conditions in policy matrix per operation	OVE (2015a) 2005-2014		2015-2019 update based on OVE country products	
	Number of operations	%	Number of operations	%
0.0 -0.249 (Mostly low-depth conditions)	3	4.2	2	7.1
0.25-0.499 (Somewhat low depth)	11	15.5	5	17.9
0.5 -0.749 (Somewhat medium/high depth)	23	32.4	14	50.0
0.75-1.0 (Mostly medium/high depth)	34	47.9	7	25.0
TOTAL	**71**	**100**	**28**	**100**

Source: OVE.

5.7 **OVE (2015a) found that sequencing of loan policy conditions followed the stages of reform cycles (formulation, adoption, implementation, and monitoring and evaluation, M&E) and tended to gain depth as the reform process advanced, but the M&E stage was seldom included.** OVE (2015a) classified the conditions in each operation according to the milestones in a policy reform cycle (formulation, adoption, implementation, M&E) that they supported. Not surprisingly, conditions in the first tranche or first loan tended to focus on earlier stages of a policy reform process, while a larger proportion of conditions in subsequent tranches or loans tended to focus on implementation. Less than 6% of the conditions reviewed included provisions linked to the last stage of a reform process M&E. Programs in the social sectors were more likely to include M&E conditions, especially when compared with those in the financial sector (0.8% of conditions).

5.8 **Conditions gain in depth as the program advances, which reduces effectiveness if the program is truncated**. OVE (2015a) found that 43% of conditions in the first PBP in a series were of low depth, while this proportion decreased to 30% in the second loan and to 16% in the third (see Figure 5.4). The analysis of OVE country products found a very similar pattern for the sample of PBPs approved between 2015–19 with depth analysis included in OVE's CPEs. On average 50% of the conditions in the first PBP in a series were of low depth, while this proportion decreased to 34% in the second loan and to 20% in the third (see Figure 5.3). While this pattern may support a progressive reform agenda, it creates challenges when the PBP series is interrupted as some of the most consequential reforms might never be implemented. Between 2005 and 2022, 32% of the PBP series were truncated (see Section V on implementation for more details).

Figure 5.3. Depth and Loan Order (PBP Series)



Sources: OVE, 2015a (document RE-485-6); OVE country evaluations and reviews published between 2015 and 2022.
Note: Both samples are not perfectly comparable as the underlying sampling approaches differ. OVE (document RE-485-6) assess the depth for a sample in only four sectors of programmatic loan operations approved between 2005-2014 representing 50% of all programmatic loans approved in that period. The 2015-19 sample uses data from country evaluations and reviews covering 36% of all programmatic loan operations approved in that period.

5.9 **The depth level of reform programs varied across and within countries**. When analyzing differences in the depth level, sharp differences across countries were detected (OVE 2015a). For example, about 22% of the conditions in Peru had high depth, compared with 9% in Colombia programs and less than 5% in Bolivia programs. Moreover, OVE found substantial differences across programs within countries. In Peru, for example, fewer than 8% of the conditions in a social sector reform program were high-depth conditions, compared with almost 30% in an energy program. The most consistent differences appeared to be at the thematic level: almost a quarter of the conditions in programs in the financial and energy sectors were high depth, compared with slightly above a tenth in the social and public sector and economic management clusters (OVE, 2015a).

VI. IMPLEMENTATION OF POLICY-BASED LENDING AND TRUNCATION

6.1 **Findings from OVE (2015a) suggest that IDB usually supports reform processes in areas in which it has accumulated experience and knowledge.** OVE mapped the interaction between policy-based lending and a set of broader but related operations in each country, using social network analysis. The results suggested that IDB tended to support policy reforms in sectors in which it had previously worked (usually through technical cooperation grants or INVs) and thus where it had some country-level expertise that allowed it to sustain policy dialogue and provide relevant technical advice. This finding is also compatible with the hypothesis that when countries need quick financial support, IDB turns to sectors where it has expertise so it can respond more quickly. SPD (2022) also finds that policy-based operations are often preceded by TC and/or INV within countries and sectors where the Bank is already involved.

6.2 **Over 80% of the PBP series approved between 2005 and 2014 were accompanied by parallel technical cooperation grants.**[18] The grants supported policy dialogue, diagnostic work, and compliance with disbursement conditions and averaged US$1.3 million per series. While the resources from a policy-based operations go to the country's Treasury, parallel technical cooperation grants provide direct support for the line ministries in charge of the reforms and can thus help incentivize them to proceed with reform implementation. While policy-based operations supported by technical cooperation grants were not found to have deeper conditions than those without such support, OVE (2015a) found that there was a significant positive relationship between technical cooperation support and the likelihood of a PBP series being completed, pointing to the importance of sustained dialogue and technical support by IDB to accompany countries' reform efforts. The presence of technical cooperation grants was neither correlated with a country's institutional capacity nor with income per capita. Less frequently (in 15 of the 82 programmatic series), INV accompanied the PBP series, with the programs either continuing a line of work initiated by previously approved INV or preparing the ground for subsequent investment operations. Looking at policy-based operations approved between 2015 and 2022 using IDB databases, OVE found lower use of TCs with policy-based operations (only 32% of policy-based operations are linked to a TC in Bank systems in the period, 51% between 2015-2019 and 0% after 2019), however, IDB databases may not adequately capture the relationship between TCs, INV and policy-based operations, see Table 6.1.

Table 6.1. Prevalence of TC linked to policy-based operations based on IDB databases

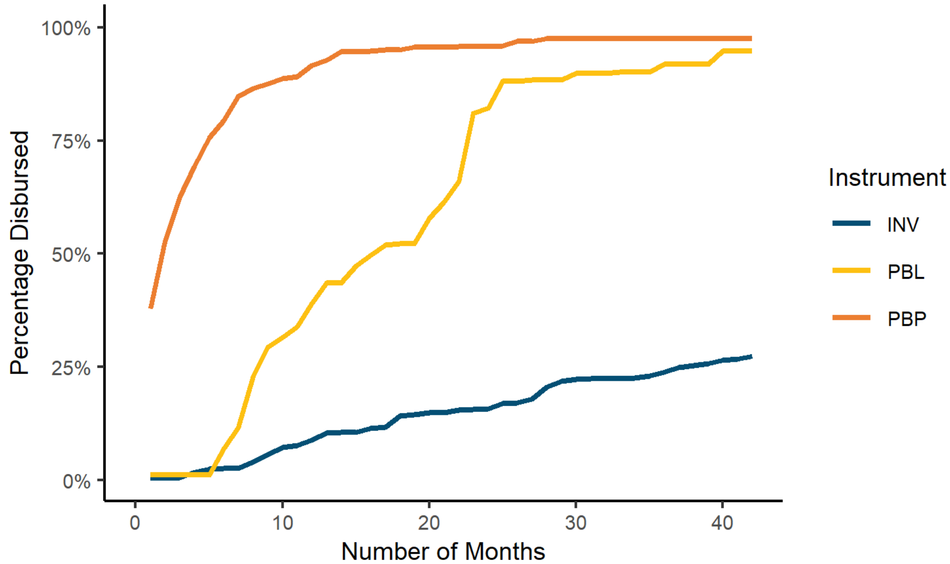
	% of operations with…		
	no TC	**one TC**	**two or more TCs**
2005-2009	78.57	10.71	10.71
2010-2014	44.12	33.82	22.06
2015-2019	50.85	37.29	11.86
2020-2022	100.00	0.00	0.00

Source: OVE based on IDB database.
Note: IDB database may not adequately report the link between TCs and policy-based operations, and therefore changes in the data may indicate a change in reporting accuracy.

6.3 **Policy-based loans are disbursed much faster than INV.** Between 2005-2022 the elapsed time between the start date in the pipeline and the approval date of a first loan in a PBP series or a PBL has been about the same as for INV. However, disbursements occur much faster after approval of a PBP or PBL than for INV. Within two months after approval, half of the proceeds of a PBP are disbursed while it takes 17 months for a PBL to disburse and 63 months (over 5 years) for an INV (see Figure 6.1). This reflects that in most cases the Bank considers that borrowers have achieved the conditions immediately after or even before Board approval. OVE (2015a) also found that there has been a tendency to disburse policy-base operations at the end of IDB's fiscal year: 54% of total policy-based disbursements between 2005-2014 occurred in December. More recent data shows that this tendency is still present but to a lesser extent (see Figure 6.1). This could be driven by disbursements during the pandemic which created incentives to disburse early in 2020.

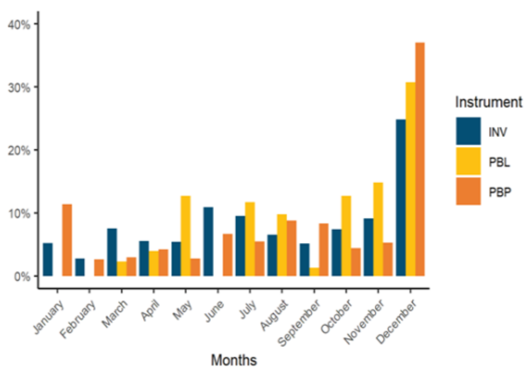
18 Data from convergence for 2015-2022 indicates a much lower prevalence of accompanying TCs; however, at this stage, it is impossible to determine if this is due to insufficient reporting in IDB's systems or because policy-based operations dramatically reduced the usage of accompanying TC.

Figure 6.1. Average disbursement time by modality for 2005-2022 period



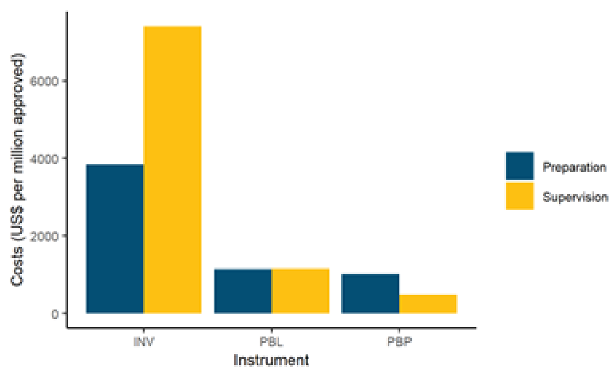
Source: OVE.
Note: PBL and PBP include data for all operations that have been disbursing during the period. For truncated PBP series this means that the executed operations are included here, whereas the operations that were not completed (oftentimes not approved operations) are not included.

Figure 6.2. Disbursements by month in 2005-2022 period



Source: OVE.
Note: Graph shows the share of disbursements that occurred in each month for the 2005-2022 period by modality. Given the lack of data on individual disbursements in INV operations, OVE used the final disbursement date for INV operations as a proxy.

Figure 6.3. Preparation and supervision costs for modality types (per US$ million approved amount) 2005-2022

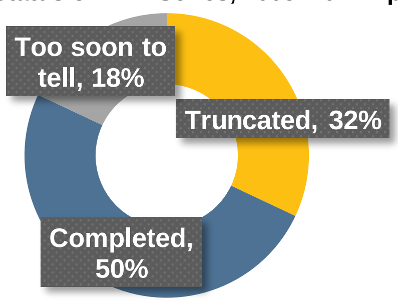


Source: OVE.

6.4 **Consistent with the shorter length of their project cycle, policy-based operations are significantly cheaper to prepare and implement than INV.** The average preparation cost per million dollars approved is roughly US$1,100 for PBLs and PBPs, compared to about US$ 3,850 for INV. In the execution stage, PBLs cost roughly US$1,150 and PBPs cost around US$500, while INV are far more expensive during supervision with a cost of US$7,400 per million US$ approved (see Figure 6.3).

6.5 **Truncation of a PBP series is a common phenomenon, but it shows a decrease in recent years.** OVE (2015a) found that of the 82 series approved between 2005 and 2014, 32% had been truncated, while 40% had been completed and the remainder were still active, resulting in a truncation rate of 44% (truncated series as a share of completed plus truncated series). As of 2022, all these operations have either been completed (45 operations – 55%) or interrupted (37 operations 45%), yielding a final truncation rate of 45%. Of the 74 PBP series approved between 2015 and 2022, 18% have been interrupted and 46% have been completed which implies a truncation rate of 28%. In the aggregate of the 156 programs approved between 2005 and 2022, 79 (50%) have been completed, 50 (32%) operations have been truncated and 28 (18%) are still ongoing (see Figure 6.4, Table 6.2), resulting in a truncation rate of 39%. The truncation rate increases with the number of operations in a series: it is 33% for series with two operations, but 47% for series with three or more operations. OVE (2015a) found no significant differences in the depth levels between planned loans (and programs) that were ultimately truncated, and fully executed loans (programs). The truncation of a PBP series may imply that some of the most consequential reforms, those with high depth, are not carried out (see paragraph 4.2). However, OVE (2015a) and the findings from OVE country products also point out that truncation does not necessarily mean that the country's reform efforts are being truncated. In some cases, the pace of the reform activities seems to slow down after a PBP series is truncated but reforms continue to be carried out.

Figure 6.4. Status of PBP Series, 2005–2022 Approvals



Source: OVE, based on data from IDB databases.

Table 6.2. Status of PBP Series by Program Size, 2005–2022 Approvals

Number of Planned Operations in Series	Completed	Too Soon to Tell	Truncated	Total
2	52	25	26	103
3	26	3	22	51
4	1	0	1	2
5	0	0	1	1
Total	79 (50%)	28 (18%)	50 (32%)	157

Source: OVE, based on data from IDB databases.

6.6 **Truncation creates transactional costs for the IDB.** OVE (2015a) found that the cost of designing a PBP series is front-loaded, suggesting—from the Bank's perspective—efficiency gains in continuing the series. Preparing the first loan of a series is more expensive than preparing subsequent operations as most of the diagnostics work is done before the start of the series, and second and third loans do not require compliance with some of the project cycle milestones (identification missions, Project Profile preparation, etc.). Therefore, the truncation leads to sunk costs for the Bank.

6.7 **There are significant variations in truncation across countries and somewhat less variation across sectors.** For example, Colombia had 20 PBP series approved between 2005 and 2022 and 9 of them were not completed (truncation rate of 45%), while Peru with a similar number of programs (16) only failed to complete 1 series (truncation rate of 6%). Similarly, Trinidad and Tobago with 6 approved series had truncated 5 series (truncation rate of 83%)19 while Guyana with 3 approved PBP series completed 100% of them. Sectors with the highest prevalence of truncated PBP series in the 2005-2022 period are the Transport sector (4 out of 7 series were not completed) Agriculture (2 out of 3) and Private firms and SME Development (5 out of 12). The sectors with more than two PBP series with the lowest truncation rates were Reform and Modernization of the State (13 out of 45) and Trade (0 out of 4). OVE country program evaluations suggest that, in countries with high numbers of truncated series (e.g., Colombia, Dominican Republic, and Panama), IDB often engaged in a new series in a different sector after a series has been truncated.

6.8 **After the initial approval of a PBP series conditions are often changed, which can affect the depth of the program.** OVE (2015a) compared the actual policy conditions in second and third loans in a sample of 28 PBP series to the indicative conditions in the previous phase and found that about half of the conditions had changed during implementation, reflecting the flexibility of the programmatic instrument (see Table 6.3). In terms of policy and institutional depth, for about 14% of the conditions in the second loan, and 19% in the third loan, the depth was found to have been reduced when the loan was approved. Conversely, the depth of conditions rarely increased.

Table 6.3. Changes to Policy Conditions After Initial Approval in 28 PBP Series

Changes	Loan 2	Loan 3
Condition unchanged	54.5%	33.6%
Condition changed but same depth	13.2%	21.2%
Condition changed depth decreased	14.1%	18.6%
Condition changed depth increased	5.7%	5.3%
Condition added	12.9%	21.2%
Number of policy conditions	**335**	**120**

Source: OVE, 2015a (document RE-485-6).

VII. FINDINGS FROM PCR VALIDATIONS OF POLICY-BASED OPERATIONS

7.1 **Validated PCRs provide some preliminary insights into the relevance, effectiveness, and sustainability of PBLs compared to other instruments.** The PCR self-evaluations are validated by OVE which assigns an outcome rating to each program (PBP series) or PBL.[20] The assessment covers three dimensions

[19] According to the CPE (document RE-495-3) the high truncation occurred because "the Bank did not adequately analyze the likely risks associated with the use of the new loan instrument, and the significant interagency coordination needed to approve, implement, and sustain the reform agenda. The Bank's failure to engage broadly with stakeholders was exacerbated by an inadequate assessment of institutional conditions. Interviewees who had been in the Government when the programmatic suite was negotiated reported a closed design process that excluded many stakeholders from the discussions with IDB. This lack of consultation was faulted for the inclusion of loan conditions that were disconnected from the working realities of the relevant ministries, and were ultimately infeasible."

[20] In the case of a PBP series, the program is evaluated against a results matrix for the entire program rather than for each loan. In the case of a PBL, the operation is assessed against the results matrix for that operation.

for PBP series and PBLs - relevance, effectiveness, and sustainability; for INV, efficiency is a fourth criterion. An overall performance rating is assigned based on a weighted average of the ratings achieved on each of these three dimensions.[21] As this system has evolved over time, comparable performance ratings are available for the 2017–2022 period for 30 PBP series and 4 stand-alone PBLs, totaling 68 loans. Validated PCRs are available for 22% of all policy-based operations approved between 2005 and 2022, which is a slightly higher share than for INV operations (20%). Four of these PCRs rated hybrid operations that combined policy-based operations with an INV or TC, which are excluded from the sample, resulting in 27 PBP series and 3 PBL for the analysis.

Box 7.1. Criteria and methodology of IDB PCR

Project performance for policy-based operations is measured against three core criteria:

Relevance: Assesses the alignment of the project to the country's needs and realities and to the Bank's strategic objectives (included in IDB high level strategic documents and Country Strategies) and vertical logic of the intervention.

Effectiveness: Measures the rate of achievement of the objectives stated at project approval.

Sustainability: Assesses the conditions that could influence the continuation of the results already achieved and the achievement of future expected results during the lifecycle of the project.

Each core criterion is rated on a four-point scale ranging from "unsatisfactory" to "excellent." Based on the assessment of the core criteria, each project receives an overall outcome rating using a six-point scale ranging from "highly unsuccessful" to "highly successful." The effectiveness rating has the highest weight in for the overall outcome rating with 60% while the other two criteria have a weight of 20%.

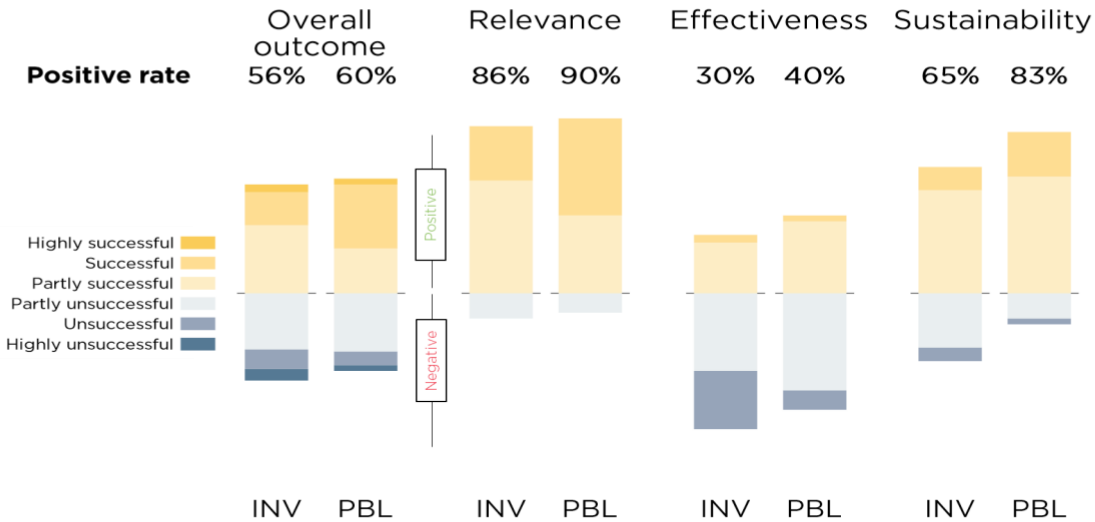
In addition to the core criteria, the PCR Guidelines require the inclusion of noncore criteria, which are rated (on the same four-point scale as the core criteria) but do not count toward a project's overall outcome rating. Among these noncore criteria, PCRs include the performance of the Bank and its counterparts (borrowers). OVE contributes to the credibility of the IDB Group's project performance reporting system through the independent validation of all PCRs and XSRs prepared by Management.

Sources: OVE, document RE-575 and PCR Guidelines, 2020 update document OP-1696-6.

7.2 **Of the 30 validated PBP series and stand-alone PBLs, 18 (60%) achieved an overall outcome rating of partly successful or higher, which is slightly higher than for INVs (56%).** Policy-based operations tend to have fewer extreme ratings (highly successful or highly unsuccessful) than INVs. Policy-based operations were slightly better rated than INVs in terms of their relevance with 90% of the programs rated excellent or satisfactory in this dimension compared to 86% for INVs. Policy-based operations with lower than excellent relevance ratings were most often penalized for shortcomings in the project design (17 out of 30 cases). Few programs were penalized for lack of alignment with country strategies (three cases) or not taking fully into account country realities (two cases). Only three PBP series (10% of the validated PBP series) had a negative rating in relevance. The one characteristic the three had in common is that they were truncated. Two of the three PBP series were in Argentina in the Reform and Modernization of the State sectors, and the third operation was in Peru in Social Investment.

21 Relevance, effectiveness, and sustainability are each rated on a four-point scale. The overall performance rating is a weighted average of the scores on each of these three dimensions, with relevance and sustainability being given a weight of 20% each and effectiveness 60%. The overall performance rating uses a six-point scale ranging from highly successful to highly unsuccessful.

Figure 7.1. Project results according to validated PCR



Source: OVE, based on validated PCRs.
Note: *N* = 312 SG operations with PCRs validated by OVE during 2017-2022.

7.3 **In terms of their effectiveness, policy-based operations ratings are 10 percentage points higher than INV** (40% are rated excellent or satisfactory vs 30% for investment loans). 17 PBPs received a negative rating, however truncation appears only a modest driver as 4 of these projects were truncated (truncation rate of 23.5%). In most cases the reason for a low effectiveness rating was a combination of not achieving the expected result and missing data to assess results. A few projects also suffered from attribution issues as selected indicators were measuring rather broad effects that can be influenced by a myriad of external factors (e.g., child mortality at country level) and the achieved results were therefore not fully attributable to the project. Sustainability is rated higher for policy-based operations (80% rated excellent or satisfactory) than for INVs (66% rated excellent or satisfactory), which is partly influenced by the fact that compliance with Environmental, Social and Corporate Governance (ESG) safeguards is assessed in INV and not in policy-based operations since ESG safeguards are typically not applied to policy-based operations. Six of the PBP series closed in a status of truncation implying a truncation rate of 22%.

VIII. Conclusions

8.1 **Policy-based lending is an important and valued instrument among MDBs and IDB is not an exception.** Since 2005 IDB's policy-based lending has accounted for about 31% of sovereign-guaranteed (SG) lending, amounting to US$59.7 billion. The reasons countries had for using policy-based lending varied, but the predominant use was to help meet financing needs. Policy-based lending as share of total lending has increased substantially with the COVID-19 crisis, accounting for 42% of SG lending between 2020 and 2022. Policy elements of policy-based operations were usually secondary to the primacy of budget support or fulfilling other liquidity and debt management needs. This points to a tension between IDB's dual policy-based lending objectives of supporting borrowing countries' reforms and helping them meet financing gaps. Many borrowers see policy-based lending primarily as a tool to help meet financing needs. This finding is common among MDBs that have evaluated the use of the instrument.

8.2 **Trade-offs between financial and reform support and use and complementarity of instruments have been identified in previous OVE's work.** Given the multiple drivers of demand for policy-based lending and the need to balance budget or debt management support with support to reform processes, many OVE country evaluations have included recommendations for improving the mix of lending instruments and modalities to better respond to countries' needs and capacities and for improving the structural depth of the policy conditions. OVE work has found that around one fifth of policy-based operations are comprised of mostly low-depth conditions. It is questionable whether a high prevalence of low-depth conditions is in line with IDB's guidelines, which stipulate that policy conditions should be essential for the achievement of expected results.

8.3 **Over one third of programmatic series approved since 2005 were truncated before they reached their most consequential reform steps, raising questions of ownership of the underlying reform programs which such lending sought to support.** Truncation was more pronounced for countries that resorted mostly to policy-based lending to meet financing needs and did not seek technical assistance to accompany the underlying reform programs. The fact that programs which were supported by TC grants had a lower truncation rate indicates there is a need for continuous engagement and technical cooperation to support borrowing countries in their reform efforts. It also suggests that evaluations of policy-based operations should not be undertaken in a vacuum; they need to consider the extent to which the operations were accompanied by sustained policy dialogue and technical support.

8.4 **The work from MDBs Evaluation Offices shows that evaluating policy-based operations is far more challenging than assessing conventional investment projects.** INV usually benefit from more clarity of performance measurement metrics and greater data availability to assess results that are attributable to the interventions. Across MDBs attribution of reform agendas to policy-based lending is not straightforward because first stages of programmatic series or operations reward actions completed before the starting of the program. Performance ratings from the sample of validated PBP series PCRs included in this note suggest that less than half of them manage to achieve their stated development objectives. Even though this rate is better than for investment lending, there is still room for improvement. The truncation of a PBP series may imply that some of the most consequential reforms, those with high depth, are not carried out. OVE's 2023 work will take a deeper look at the effectiveness of policy-based lending, analyzing in more detail its additionality to promoting needed reforms in its client countries to improve the balance between financial support and reform support.

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