World Bank Instruments and New Initiatives

A Report for DFID

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Acronyms

AL	Adjustment Lending
APL	Adaptable Program Loan
CAP	Community Assistance Program
CDF	Comprehensive Development Framework
DFID	Department for International Development
ESW	Economic and Sector Work
EU	European Union
HIPC	Highly Indebted Poor Country
IGR	Institutional and Governance Review
IMF	International Monetary Fund
M&E	Monitoring and Evaluation
MTEF	Medium Term Expenditure Framework
OCS	Operational Core Services
OPS	Operations Policy Staff
PER	Public Expenditure Review
PERL	Public Expenditure Reform Loan
PIO	Programmatic Investment Operation
PRGF	Poverty Reduction and Growth Facility
PRP	Poverty Reduction Program
PRS	Poverty Reduction Strategy
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
SIM	Sector Investment and Maintenance Loan

1. Background

1. The World Bank has moved in the past few years toward introducing a more integrated strategic framework for its operational activities. The Comprehensive Development Framework (CDF) postulates a set of principles (e.g., country leadership, broad participation and consultation, partnership) for the formulation of a long-term vision and strategy to support a holistic economic and social development program. Utilizing CDF principles, the Poverty Reduction Strategy Paper (PRSP) for low-income countries would integrate poverty-reducing policies and costed programs into a coherent, growth-oriented macroeconomic framework. This and the CDF are expected to provide the basis for development assistance for low-income countries from all partners.

2. A fundamental principle of both these initiatives is that the country itself must take the leadership in defining and implementing programs and organizing donor activities. A central feature is, therefore, the building of country capacity to do this. Box 1 indicates current thinking on the key operational characteristics of the comprehensive approach. Because this approach seeks to integrate all activities within a coordinated assistance program, it will require a far greater degree of coordination and cooperation among funding agencies than has been the case. Further, these developments suggest the need for a change in the nature of the operational instruments used for both analytical and resource transfer purposes.

Box 1. Key characteristics of the comprehensive approach

- Broader coverage of the medium-term expenditure programs, going beyond specific projects to sectors, multisectoral programs or the entire MTEF, for a more integrated approach;
- Longer-term programs, which should receive sustained Bank/donor support through a series of time slice operations;
- Progress measured by results—development indicators that show outputs and outcomes and measures of effective management;
- Flow of funds in any given year aligned with budget requirements and progress in the implementation of the program, with the level and continuation of support over the medium- and longer- term tied to outputs and outcomes;
- Focus on step-by-step institution building and policy reform as indicated by prior/parallel analytical and advisory work based on the needs of the program;
- Support by a partnership between the government and donors, who coordinate their assistance within the framework of the program.

3. The need for increased Bank/donor collaboration under a comprehensive approach raises issues for bilateral donors such as DFID. To what degree is it in agreement with this move to a more strategic approach? What are the implications of this new approach for its operations? If it does share the objectives, how can it contribute to the further development of this initiative? How should it modify its mode of doing business to better support the new approach? If it has different views or sees ways of enhancing the approach, how can it most effectively engage the Bank to achieve its objectives? How should it work with other country aid programs to build support for, or seek modification in the approach?

4. The following discussion focuses on the evolution in World Bank instruments and analytical work, which is now taking place in the context of the introduction of CDF and PSRP frameworks. Progress reports have just been submitted to the Bank's Board on the CDF, the PSRP process and the HIPC Initiative.[1] These, together with discussions with staff working on the CDF and PSRP, provide a fairly clear idea of the state of development of these programs. A recent paper on Supporting Country Development[2], which is scheduled to be discussed at the Development Committee on September 25, sets out the Bank's proposals for incorporating the PRSP into the CAS process, introducing a more systematic approach to analytical work and supporting the PR program with a "Poverty Reduction Support Credit" (PRSC). [3]

5. This note attempts to identify the key issues in lending and analytical work that emerge from recent developments. It will discuss how they are currently being addressed by the Bank's Operational units and what considerations will bear on the effective application of new instruments and policies. It then suggests how DFID may wish to define its response to the Bank's initiatives.

[1] Heavily Indebted Poor Countries (HIPC) Initiative and Poverty Reduction Strategy Papers: Reports on Progress in Implementation (SecM2000-487), August 14, 2000.

[2] Supporting Country Development: World Bank Role and Instruments in Low- and Middle-Income Countries (SecM2000-435), July 21, 2000.

[3] Proposals for middle-income countries are also covered, but this note is concerned primarily with the proposed Bank approach in low-income countries.

2. Developing appropriate instruments

6. Given the needs of a comprehensive program, there is general agreement within the Bank that instruments must become more "programmatic" to provide the effective support to the CDF and PRSP. Programmatic tools already being used include the Sector Investment and Maintenance loan (SIM), the Sector Program variant of this as used to support sector-wide programs in the Africa Region and the Adaptable Program Loan (APL). New lending instruments are being added to the tool kit--Programmatic Structural Adjustment Loans (PSALs), Poverty Reduction Support Credits (PRSC) to support Poverty Reduction programs and Public Expenditure Reform Loans (PERL), although this last is not an official Bank instrument. Annex A provides a comparison of the characteristics of these operations.

7. The Bank is also adding to the toolkit of economic and sector work. In addition to Public Expenditure Reviews and Poverty Assessments, the Bank is piloting Institutional and Governance Reviews (IGR) as a complement to the PER to provide a broad gauge assessment of the quality of accountability, policymaking and/or service delivery institutions in a country and is considering the introduction of human development assessments that would provide an overall framework for ESW. It is also enhancing more traditional instruments such as country procurement and financial management assessments. As noted in the recent Bank report on "Fixing ESW"[4], "…The Bank Networks are working together to develop proposals for a more systematic approach to the country diagnostic work needed to support the CDF pilots and PSRPs." Little has yet emerged on this, however.

8. While work on defining these programmatic instruments is still ongoing and there is much debate on them within the Bank, it is clear that, in addition to close coordination of donor and Bank programs, the operational characteristics that would best respond to the needs of the comprehensive approach outlined above are:

- Regular assessments of policies, spending priorities, program performance and fiduciary issues. These should be undertaken jointly by Government and financing partners with broad participation, as part of the institutional environment within which assistance is provided.
- Flexibility to impose or relax policy conditionality or restrictions on the use or management of funds, based on those assessments.

[4] Fixing ESW: Where Are We? Discussion Draft, July 11, 2000.

- Where assessments are positive, general support for agreed plans and expenditure programs at budget or sector level, without earmarking funds for specific activities.
- Predictable phasing of disbursements to permit budget planning and cash management.
- Procurement, disbursement and accounting and audit arrangements, which use Government procedures without imposing additional burdens to satisfy Bank or other donor requirements.

9. Again, the capacity building theme is central. The fundamental constraint that the Bank and other donors must confront is the ability of the country to carry out the program. The old methods of assuring that projects were executed, which relied on the application of tight Bank/donor procedures and controls (sometimes setting up special units or directly taking some management responsibility) is not feasible with the programmatic approach that is grounded in country ownership and leadership. Such operations must rely on the country's own systems and capacity to ensure that objectives are met. In fact, a major benefit of a programmatic approach is that it makes institutional development a central objective. Box 2 outlines the key elements of capacity building for programmatic lending.

Box 2: Capacity building for the programmatic approach to lending

- Assess the institutional strengthening measures required to support the planned program. These should cover public national-, local-level and private sector requirements
- The country leads regular review of policies and program performance, through a process in which civil society and donors participate.
- Government and donors assess the fiduciary environment, establish an action plan to build capacity, overcome problems and regularly review progress.
- Funding agencies move over time towards reliance on Government procedures for procurement, disbursement and accounting and audit.
- Joint monitoring and review against agreed indicators covering inputs, outputs, and outcomes re both program performance and program management.
- Funding agency commitments and modalities evolve in the light of progress in the areas of policy, program execution, and the building of management capacity (with particular regard to fiduciary management) and track record.

10. In the context of the programmatic approach the traditional fiduciary concerns of sound financial management and procurement will be a crucial focus of institutional development efforts. The capacity to properly

manage and account for financial resources (at both the national and local levels) and to properly procure goods and services is essential to effective program management. Further, unless the Bank and donors can have confidence that their resources are being used for intended purposes they will have difficulty in justifying their support. The "Supporting Country Development" paper describes well the challenge this presents to the Bank and donors:

"The Bank increasingly collaborates with other donors in a programmatic way, either co-financing projects or pooling resources to fund entire programs. Success in such collaborations would be greatly facilitated if there were a common set of fiduciary and safeguard policies acceptable to donors and clients alike. This would reduce the transaction costs of development assistance, especially for recipients, who must now deal with a plethora of different procurement, reporting, environmental and social requirements from donors and development partners. Thus, one of the key challenges is to harmonize operational requirements and procedures across the development community."

3. How is the Bank addressing these issues in practice?

11. The CDF paper focuses mainly on progress in the application of the processes underlying the CDF, mentioned above. There is little, however, on the implementation of a CDF program. The brief discussion of implementation of CDF programs suggests that more programmatic lending would be desirable. A matrix indicates the extent to which programmatic instruments are being utilized currently. Generally, it shows that Adaptable Program Loan (APLs) type operations are being introduced to support the CDF programs. In part, this lack of focus on implementation strategy and program instruments as opposed to foundation activities such as establishing a vision, partnership, and a participatory process is because progress has been limited in most countries. A number have been affected by conflict (e.g. Ethiopia, Eritrea); others are still working on their "visions". Very limited institutional capacity makes it difficult to move forward (e.g. Vietnam, Morocco, Romania) without substantial, still to be completed analytical work as a foundation for system and institution building. A review of the recent CDF country CASs reveals little about implementation strategy for most of them. No clear thrust is discernable in most cases and standard lending instruments seem to be proposed. Although APLs are being utilized, many seem to be narrow in scope and do not involve significant donor partnership.

12. Nevertheless, some CDF country programs are now being shaped strategically (e.g. Uganda, Ghana, Bolivia), and there has been serious introduction of programmatic instruments. In addition to these country programs, a great deal of work has been done in Jordan and in Benin on laying the foundation for a comprehensive program, although Jordan has apparently opted out of the formal CDF pilot and Benin was never a part of it (but is a PRSP country). These country programs are in the forefront in trying to design operations that would provide appropriate support for the emerging development strategies. The rationale for the programmatic approach underpinning these programs is set out in the draft Uganda CAS[5]:

"…we believe this shift in focus requires a change in sector lending modalities…away from traditional short-term structural adjustment operations and discrete investment projects to one of supporting a comprehensive reform program...by way of Programmatic Structural Adjustment Credits (PSACs) …[which] would provide a more effective mechanism to address constraints at the sector level…[and] focus on cross-cutting reforms in public sector management….The shift to PSACs is also attractive in that it can provide direct support for the Bank work on implementing a CDF.

12. Uganda, Benin and Jordan have moved toward the development of budget support operations that go beyond projects and involve sustaining a medium-term expenditure program. A key characteristic of these operations has been the priority given to building the institutional framework needed to ensure that the programs are well designed and can be implemented as planned. This means supporting the development of local systems and building local institutions to the point where they can be relied upon to meet agreed objectives. In Ghana, the approach has been to build sector by sector using sector programs and APLs in parallel with programs design to support public sector reform and capacity building. Bolivia has organized its development program on the basis of four objectives (Opportunity, Equity, "Institutionality" and Dignity), which are consistent with CDF building blocks and which provide the integrating framework for the program. Programmatic and intersectoral operations, most using the APL are being developed on this basis.

13. The PRSP initiative is newer than the CDF and so there has been less time to develop a response to it. In addition, since the PRSP is the basis, in the first instance, for debt relief the initial proposal was not linked directly to lending support until the recent introduction of the PRSC.

[5] Draft Country Assistance Strategy of the World Bank Group for the Republic of Uganda. August 16, 2000.

However, all countries receiving concessional assistance—not just debt relief—are required to prepare PRSPs and, if current management proposals are accepted, the PRSP will become an essential element of the CAS by July 2002. Thus far, two full PRSPs have been submitted (Uganda and Burkina Faso) and 11 interim PRSPs--the first step in the process—have been submitted as of August 2000. Currently, in addition to debt relief, the PRSP provides the basis for the Fund's Poverty Reduction and Growth Facility (PRGF) operations. The proposed PRSC would be available to all countries which have an adjustment relationship with the Bank or which have a PRGF.

4. Evolution of Bank lending instruments

14. The cutting edge country programs discussed above provide an initial indication of the factors influencing the shape of programmatic lending instruments, the criteria for their selection and the problems they raise. It is clear that these are ambitious undertakings. Building institutional capacity to carry out such programs takes time and effort. Different approaches have been taken and instrument design is still evolving. It is worth quickly reviewing the range of possible Bank instruments and their attributes in the context of the comprehensive program approach:

Adjustment Lending (AL).

15. This instrument has traditionally been designed to fill balance of payments gaps rather than to support expenditure programs. AL is generally conditioned on macro, sectoral or structural policy reform and disbursements against imports (usually on a negative list basis) are triggered by policy reform and implementation actions. While they provide budget support through the generation of counterpart funds this has not been the principal objective and there has been little monitoring of, or conditionality attached to the expenditure program (beyond general fiscal reform requirements). Also, since the flow of resources depends on policy implementation, unless it is a single tranche operation with conditionality met up front, the flow of resources may be uncertain, particularly where floating tranches are used, so this instrument is not suitable for expenditure program support.

16. It is generally agreed that while adjustment operations effectively support institutional reform, they are not appropriate for capacity building. They are too sporadic and short term and do not lend themselves to the "on the ground" engagement needed for this. For this purpose, separate technical assistance operations have traditionally accompanied adjustment lending.

17. Because AL only finances balance of payments support, the usual Bank fiduciary requirements do not apply to it. A proposal to refine requirements is now being considered, but this still would not go much beyond assuring that the overall financial management performance of institutions handling Bank adjustment funds is satisfactory. Except in the case of sectoral adjustment loans, safeguard policies covering environmental and social issues have not been applied, given the macro focus of ALs.

Programmatic Structural Adjustment Lending (PSAL).

18. This modality was introduced in October 1998. Such operations (of which three—Thailand, Latvia and Tanzania—have so far been approved) are designed to provide more consistent Bank support for medium-term government programs such as might be embodied in the CDF or PRSP. The PRSC is considered to be a PSAL instrument. While the PSAL is relatively new, its use thus far—beyond its longer-term focus, which generally involves a commitment to a series of such operations—does not seem to differ significantly from traditional AL. The principal objective of the operations approved to date has been to improve public sector performance through strengthened fiscal management (including performance-based budgeting), civil service reform, improved tax management and decentralization of service delivery and privatization and regulatory reform. Disbursement modes may differ. The Thailand operations are designed as single tranche operations. On the other hand the Tanzania operation provides an initial tranche to be followed by four floating tranches.

19. The choice of instruments to support comprehensive approaches has moved steadily in favour of the PSAL. In the cases of Uganda, Jordan and Benin, the initial approach to instrument design was to choose what was viewed as a programmatic investment approach (discussed below). These operations have now all been converted to PSALs (PRSCs for Uganda and Benin). The Lending Retrospective paper of November 1999[6] discussed both programmatic lending and adjustment instruments. The Supporting Country Development paper now only deals with PSALs. The emphasis on adjustment lending is a consequence primarily of concerns about how to deal with fiduciary and safeguard requirements that would be applicable to investment operations, but are not generally applied in the case of adjustment operations. Thus adjustment lending is

[6] Lending Retrospective: Volumes and Instruments, Issues Paper. Operations Policy and Stategy. November 15, 2000.

seen as a more viable route for providing budget support in the near term. Further, programmatic investment operations might pose difficult disbursement issues, as discussed below.

20. What then are the differences between the two modalities and what are the implications for program design? The Bank, in both the CDF and PRSP has put great emphasis on the achievement of results—that is the achievement of program outputs that ultimately result in desirable outcomes, primarily the reduction of poverty. If there is a substantial policy reform agenda that must be dealt with to lay the foundation for effective service delivery programs then programmatic adjustment lending would seem to be the instrument of choice. This applies to macroeconomic, sectoral and public sector management policies.

21. But getting the policy framework right is only the first step. Delivering programs on the ground is essential to producing the desired outcomes—promoting growth and poverty reduction. If the policy framework is more or less in place the challenge becomes building the institutional capacity to deliver the program. This involves the use of longer-term instruments that provide a timely and regular flow of resources. It further involves a sustained institutional capacity building effort to develop, step-by-step, program, financial and administrative management skills and systems at the central and decentralized levels. To accomplish this, PSALs must be designed to provide an assured flow of resources in response to program execution requirements and they must incorporate or be accompanied by the capacity building programs. If PSAL disbursement is to be responsive to program execution needs, it cannot be tied to policy conditionality during the course of an annual budget exercise. The use of single tranche, up-front disbursement would help Governments to plan their budgets based on a reliable estimate of external resources. This suggests that all major policy issues — in the relevant phase of the policy agenda—must have been satisfactorily accomplished as a condition for undertaking the operation. In practice, however, when seen from the viewpoint of a Finance Ministry, the issue is more complex than this, and the difference between ex ante and ex post conditions may become less significant if multi-year operations or a long-term relationship are envisaged (see section on conditionality).

22. The design problems posed may be difficult but they are being tackled in the country programs cited above. These started out as and are intended to be budget support operations. They will aim at filling a fiscal gap and their disbursement will be linked closely with the execution of the expenditure program rather than a policy reform agenda. Adjustment of future tranches will be based on program execution as well as policy performance. They are likely to substitute, in large measure, for

traditional investment lending. Under these circumstances, the question will inevitably arise as to whether these are programmatic adjustment or investment operations. As noted above, the implication is that if they are regarded as investment operations they must comply with the Bank's fiduciary and safeguard requirements. This issue is discussed further below.

Programmatic Investment Operations (PIOs).

23. It is coming to be generally accepted that the comprehensive approach is best served by the use of programmatic instruments that cover whole sectors, are multisectoral or cover the entire MTEP.[7] This reduces the risk of fragmentation, enhances collaboration, makes for more effective conditionality, provides more reliable financial support and tends to focus attention on broad institutional development and capacity building issues, rather than on specific projects.

24. The Sector Investment and Maintenance operation (SIM), which emerged in the 1980s, is such an instrument. It aims at supporting an entire sector program both investment and recurrent costs. It is based on an overall sector strategy and program, but disburses as a traditional investment operation. In the 1990s, a variant was developed for the Africa Region — the Sector Program — to help deal with the problem of weak country capacity and ownership, uncoordinated donor programs and lack of a coherent sectoral framework. Adaptable Program Loans (APLs) were introduced in 1997 and have become very popular. They can be designed to support sectoral or multisectoral operations and have a built in risk management feature. They provide for a long-term Bank commitment to support a program, but each phase of the APL has a relatively short-term execution period. It can therefore be used to address priority issues (such as capacity building or policy reform), set targets, and condition subsequent phases on satisfactory performance. As noted above, many CDF programs such as Bolivia and Ghana are using, or intend to use this instrument.

25. The Bank's work on lending effectiveness led to the conception of a broader budget support operation that would go beyond the sector approach and encompass an entire public expenditure program. The Public Expenditure Reform Loan (PERL) is not yet a formal Bank instrument. Efforts to develop such operations have been underway in Uganda, Benin and Jordan, although these will now be cast as PRSCs.

7. Comprehensive Development Framework Report on Country Experience, March 1999 – July 2000 (SecM2000-474), August 10, 2000.

These, however, remain basically budget support operations built on the foundation of successful policy reform and extensive work in building institutional capacity. The advantages of the PERL are that, since sectoral walls do not bind them, they deal with fungibility issues and institutional capacity building more effectively than sector-based operations.

26. Finally, the programmatic investment approach can be multisectoral without extending to the entire expenditure program. The pillar APLs in the Bolivia program are one example of this. In addition, the concept of a multisectoral Community Action Program (CAP) that would concentrate on building service delivery capacity at the local level is now being developed in the Africa Region. This might take the form of a multisectoral social fund, or a fund to support local government operations. At its broadest, this approach would provide the basis for a PERL-type operation. The aim is to support institutionalization of such a community-based approach so that it is integrated within the budget, and the programs of line ministries and local governments.

5. Fiduciary and safeguard issues

27. PIOs are based on expenditure programs and disburse based on their execution. Thus they can provide reliable support and can give attention to expenditure program performance and capacity issues at the national and sectoral levels. The problem noted above with the use of both sectoral and multisectoral PIOs is that they raise difficult fiduciary (procurement, disbursement and financial management) and safeguard (environmental and social) policy issues for the Bank.

28. Such problems are emerging even with sector programs, with which the Bank has extensive experience. Fiduciary and safeguard requirements were designed for traditional investment lending. There was no problem as long as the sector operations (known as Sector Investment Programs in Africa) followed the traditional mode (i.e., the Bank-financed activities, as well as other donor activities fit within the sectoral policy and program framework, but those activities were packaged as traditional projects with standard fiduciary controls). But difficulties have arisen in the latest operations (e.g., Ghana Health, Mozambique Agriculture), which have attempted to move beyond a set of separate donor projects and to bring all donors into a common or pooled fund on budget. The Bank's fiduciary requirements are designed to "ring fence" Bank resources and ensure that they are used for "intended purposes". The Bank's and IDA's Articles of Agreement have been interpreted to mean that this requires that the

Bank disburse against specific eligible expenditures. However, once fungible resources are pooled they lose identity and cannot be linked to specific expenditures. This issue has arisen in the Africa Sector Programs that have attempted pooling, and in the case of Bank-administered donor trust funds in Bolivia.

29. The justification for considering pooled funding as meeting Bank fiduciary requirements must be grounded in the establishment of financial and procurement management systems for the entire program that meet Bank standards as set forth in the Procurement Guidelines and the Financial Management OP/BP10.02. Where efforts have been made to accomplish this, even on a sectoral basis (e.g. the Ghana Health Fund) it has proven challenging. The capacity building work takes time and resources. The Bank’s Legal Department has not yet accepted the proposition that this would be an acceptable approach under the Articles that would justify breaking the direct link between disbursements and expenditures. Finally, the Bank has not yet defined what would be minimum fiduciary standards that would apply to it if it were to agree to this approach. All donors participating in the pool would have to accept common arrangements so harmonization becomes imperative and in some areas, such as procurement, it is not clear that complete harmonization is feasible or desirable. This is discussed further below.

30. Thus far the issue of pooling funds in a programmatic investment operation is only being tackled in practice at the sectoral level. The problem becomes more complex if the operation is intended to support the whole or a large part of the public expenditure program. The entire governmental procurement, budget, financial management and accountability system must meet Bank standards. Also, arguably, government environmental and social safeguard systems must be acceptable. This is why the Bank is hesitating to embrace such instruments. It may perceive a chicken and egg problem that could delay the implementation of a PRS program. What is needed, however, is the establishment of minimum standards, a satisfactory program for building capacity, risk management safeguards and a reasonable judgment as to the level of resource transfers in relation to capacity to effectively utilize them. In the longer term, there is little choice in moving in this direction, whether it is done through adjustment or investment instruments. Assisting Bank borrowers in building national systems with the capacity to ensure proper management of, and accountability for the use of public resources is a central element of the comprehensive approach to development that the Bank is espousing. It is a critical development challenge.

6. Major issues to be addressed.

30. The question then is how best to meet this challenge? The identification of key issues for DFID should be guided by this question, and it should be the basis for its engagement with the Bank. The fundamental problem is how to build capacity, support programs and transfer resources in a way that achieves poverty reduction objectives. Of course, the mix and sequencing of activities and instruments must be adapted to each country circumstance but what would be the basis for selecting this? How should resource flows and capacity building be coordinated? How can consistency with the macroeconomic framework be achieved? Given the imperative of donor collaboration and harmonization, these issues must be resolved by consensus insofar as possible. The client must agree and all participating donors must be comfortable. Programmatic instruments raise design questions, including risk management, the handling of conditionality, disbursement arrangements and the need for good monitoring and evaluation systems. Finally, how should the Bank deal with its own rigidities so that it can provide leadership? These issues require priority consideration.

Capacity Building and the Role of ESW

31. The Bank report on Supporting Country Development spells out a framework for diagnosis which, together with the country's PRSP, would underpin the Bank's business plan for the country. The recent report on Fixing ESW[8] identifies serious gaps in country knowledge, particularly in what is referred to as "due diligence" ESW, including: poverty assessments, public expenditure reviews, fiduciary assessments (covering procurement and financial management), and country economic memoranda of various types. As "due diligence" implies, this work is considered an essential basis for Bank programs. The report notes that in the 52 countries expected to produce PRSPs over the next two years, only a small number have up to date due diligence ESW, with key fiduciary/institutional reviews being the most frequently missing elements. Almost 70 % have had poverty assessments, but 2/3 of these are out of date. In the CDF pilot countries, the situation is somewhat better, with a third being up to date on fiduciary/institutional reviews. Only half have up to date PERs.

32. Two related issues arise in connection with ESW for comprehensive programs. The first is how priority ESW should be identified for these programs and the second is how this work should be undertaken to best

[8] Fixing ESW: Where are we? OPS. Discussion draft of July 11, 2000.

contribute to building the capacity needed to formulate and carry out comprehensive programs. Establishing priorities is essential because resources available for ESW are limited. A principal value of ESW is the contribution it can make to identify key capacity problems that require action. This is particularly true for fiduciary/institutional analyses and PERs.

33. The strategic framework for identifying priority ESW should be established in the CAS and should be based on the CDF and PSRP strategies. Of course the results feed back into the CAS. The key areas of work for advancing a comprehensive program are:

- Developing the policy and strategy framework;
- Formulating an MTEP based on the strategy and macro framework;
- Assessing capacity to carry out the program;
- Identifying appropriate performance measures;
- Establishing fiscal and program management systems;
- Formulating sector (including private sector), policies strategies and programs based on the strategic vision and performance measures; and
- Establishing a sound fiduciary framework to ensure that resources are used properly and accounted for.

34. A collaborative process should be established in every country for assessing the analytical needs in these areas. The questions are: i) what is the basis for undertaking this assessment; ii) how are analytical needs to be assessed and by who; iii) how should the work be prioritized; and iv) how should work be coordinated and by who?

35. Under CDF principles, the government should play a lead role, but in practice most (especially the poorest which tend to have weakest capacity) will need support. What is the process by which donors coordinate that support among themselves and with government, and decide how and what to contribute? Partnership is acknowledged to be a fundamental principle for a comprehensive program, but how is comparative advantage to be assessed and fostered and what would be the mechanisms for achieving a reasonable division of labor? The Bank and donors must work together under country leadership to answer these questions.

36. Some approaches being developed within the Bank could point the way for establishing such a collaborative process. One example is the approach that has been taken in Jordan, where a PERL type instrument is being developed. A Public Sector Review that dealt with sectoral

programs, poverty trends, the development of an MTEF and civil service reform was the basic instrument for identifying key analytical and capacity building work that would be required. On this basis a series of sector work and capacity building tasks were identified, and donors and government have come to agreement on who would be responsible for what. In the Africa Region, the effort to formulate a community-based approach to development is producing proposals on how to address capacity building issues on a more consolidated basis that would open the door to greater donor collaboration.

37. The Bank must go beyond focusing on ESW needs primarily from the perspective of meeting its own "due diligence" requirements. There is a need to develop processes that will ensure that ESW needs are directly related to the analytical and capacity building requirements of the comprehensive program and that they are formulated and carried out in a collaborative fashion.

38. It may be helpful to distinguish the role of the Bank in establishing due diligence, from the capacity building role of technical co-operation:

- The Bank and other funding agencies inform Government, preferably based on a dialogue and on diagnostic work, of their minimum requirements for providing programmatic support using Government channels.
- Government works up a response to the donor requirements, probably with technical support financed by the Bank/donors, though that technical support should be clearly responsible to Government, and should be free of divided loyalties to the funders.
- The agencies have a role in assessing progress against objective criteria, and the Bank may have a particular role in providing such assessments on behalf of the donors. It is important, however, that the Bank should not assume a monopoly as the arbiter of performance.

39. This separation of roles is important across all major pieces of World Bank ESW. Evaluations of both poverty assessments and of PERs found that they had little impact on policy in most cases, mainly because they were not usually integrated into the Government policymaking and budget process. The PRSP process rightly places emphasis on Government leadership and drafting of the PRSP, with the Bank/Fund role limited to providing an assessment of it, and drawing the implications for their own lending and for access to HIPC. Similarly, the MTEF process in Uganda and Tanzania has seen Governments acquiring their own capacity for analysis of public expenditure issues, drawing on a range of

sources of technical support, and integrating the review of public expenditure within Government's own budget cycle. The role of the formal World Bank PER is again limited to assessing the Government process, though the Bank has also on invitation provided valuable technical support to the MTEF process.

40. An issue for the new approaches is how to ensure that the Bank holds off from driving them, responding to demand for technical support rather than leading policy development. The problems of capacity building are not primarily technical in nature. They require political and managerial determination to tackle sensitive and long-standing issues:- pay reform, corruption, the introduction of a stronger performance culture in Government, often in the context of major reforms to the role of Government and the credibility of the planning and budget process. The necessary commitment will only be forthcoming where Government is seen to be fully in charge of the process.

Sequencing: Financial Support and Government Capacity

41. If capacity to manage resources effectively to accomplish agreed objectives is the binding constraint how do we develop programs that both enhance capacity and transfer resources?

42. One view is that the Bank should develop a set of commonly accepted standards for evaluating institutional capacity, apply instruments that have proven effective in building capacity, and tailor resource transfers to capacity to manage them effectively. Resource transfers can be increased in line with progress on capacity development.

43. This approach is reasonable provided that some perspective is maintained. Capacity building takes place over long periods of five to ten years, and the approach taken to capacity building requires careful diagnosis, since there is enormous variation in the causes of weak institutional performance, and in the extent to which outside interventions can help to overcome them. Where institutions are weak, it should not be the level of resource transfers that is affected so much as the extent to which resource transfer relies on Government systems and how effectively such systems can be monitored. For this reason, the critical issues will be: i) the capacity assessment of government systems; ii) the establishment of "minimum capacity" criteria and targets for improvement, and iii) the development of risk mitigation instruments such as expenditure tracking and sample transaction testing to help ensure that management is devoting resources to intended purposes. There is much to be said for a graduated approach, which makes increasing use of Government systems as careful monitoring confirms that Government

has the capacity and commitment to make good use of the funds. This is a tall order, but there is experience already to demonstrate that it is doable.

44. The Ghana program is designed on this basis. It has two parallel thrusts. The first is to develop sectoral capacity through a series of Sector Programs using the APL instrument. The second is to build overall public sector management capacity through a series of public sector, financial management and decentralization operations. As national, sector and local level capacity is increased the program could move toward the use of broader instruments such as MTEF budget support. But a step-by-step approach is being taken. In the case of Uganda, substantial progress in economic and budget management has been achieved and the judgment is that it is possible to begin budget support with a focus on those sectors where there is confidence in management capacity to implement the agreed program. The CAP concept being developed in AFR takes this building block approach. It would build programs up from an expanded social development fund approach to a budget support instrument as capacity is demonstrated.

45. Experience to date indicates that a step-by-step approach is best, and the instruments that permit this such as APLs or single tranche programmatic adjustment operations are well suited to supporting such an effort. These can be used to build capacity on a sector-by-sector (or cross-sectoral) basis in tandem with central level capacity development, as in the cases of Ghana, Bolivia or Uganda. In countries with more developed institutions, such as Jordan it may be possible to move directly to PERL-type instruments to provide broad budget support. The ultimate objective is to nurture development of a national system that can assure that resources are being used to achieve agreed objectives.

46. Until management capacity reaches the point that programmatic instruments can be used to help finance the entire expenditure program they are likely to be accompanied by project lending to deal with specific sectoral constraints that require a more “hands on” engagement. In addition, as has been seen, technical assistance to support capacity building is likely to be a common feature of comprehensive programs. The specifics of each country situation will determine the choice of instruments, but the criteria for selection and transition strategy should be spelled clearly in the CAS. Currently this is not being done, but it should be required. It may require the development of diagnostic tools and guidance.

Monitoring Performance

47. The stated objective in most of the cutting edge country programs is to assist the countries to move to a performance management system. Results agreements would be the basis for making resources available and management information would provide the basis for resource allocation and program adjustment. Whether fully developed results-based systems are ultimately established or not (and this would be a difficult objective) the importance of substantially improving performance information is clear. In most countries, certainly in the lower income countries that this note focuses on, systems to provide such information are weak. Further, not only must information be made available but there must also be a capacity to utilize it for purposes of management decision-making.

48. The Bank has been attempting for some time, with the assistance of a number of bilateral donors to support development of monitoring and evaluation systems (M&E) that would underpin performance management arrangements. Progress has been very slow. Only a few countries have advanced in the development of such systems, despite their importance for undertaking comprehensive programs. For example, in the case of Uganda, which is ahead of most, there is still much work to be done in moving beyond input measurements toward generating information on outputs and outcomes, with emphasis on service delivery, to more effectively incorporate information into the decision-making process and to develop clearer long-term goals and align output and outcome targets with them.[9]

49. A Working Group set up to consider how the Bank might more effectively address the development of M&E systems has reported its findings to the Board's Committee on Development Effectiveness.[10] The perspective of the report is that of Bank needs. It confirms that traditional project-based M&E is proving inadequate and that for M&E to support effective investment for poverty reduction within the CDF, borrowers and the Bank should shift from tracking inputs and deliverables to focusing on results and performance that could provide useful information for the management of the program. This will require capacity building both within the Bank and for its borrowers. The pilot proposed to be implemented would run through FY03 and the new approach would be implemented starting in FY04.

[9] Strengthening National Monitoring and Evaluation in Uganda. Arild Hauge. Preliminiary Report August 2000.

[10] Report of the Working Group on Improving Quality of Monitoring and Evaluation in Bank-Financed Operations (CODE2000-72). June 29,2000.

50. This initiative is long overdue and welcome. It recognizes that the comprehensive approach requires addressing governance and public sector transparency and creating effective national and international partnerships. But the pilot approach proposed still seems to be very much oriented to Bank operational needs. The orientation must become more country- and less operations-focused to deal with the kinds of issues identified in Uganda. Unless M&E systems are incorporated in the country's own public sector management systems and the information provided is utilized as a basis for decision making on resource allocation and program design at all levels of government, they are not likely to take hold. The approach now being taken in a Ghana pilot to support a broad improvement in M&E, rather than a project specific development is more likely to lead to the introduction of sustainable systems. The Bank should be urged to move more in this direction.

51. It is important to recognize that relating public expenditure to results and performance is extremely difficult to do, and it is unclear that any country, including those in the OECD who have tried hardest, has been fully successful with the approach. At one extreme, an elusive search for comprehensiveness can waste resources in relating expenditures to objectives which are so general that they encompass every conceivable activity which Government may wish to undertake, and are therefore valueless for sharpening focus or evaluating performance. At the other extreme, highly specific objectives can distort decision making towards what is targeted and measurable rather than what is important, e.g. with a target to reduce hospital waiting lists distorting clinical judgments, or exam pass targets leading to a focus on those pupils close to the required standard but the neglect of the most and least able children. Uganda has shown that simpler techniques which challenge Departments to show how their expenditure programmes contribute to national goals can be quite powerful where those goals are clear enough to discriminate between expenditure programmes. A focus on empowering people to demand more of Government, a hard budget constraint within which departments are free to make choices, and an opportunity for peer pressure through better information, can all contribute powerfully to more effective expenditure allocation and management. It is important to ensure that results-based management does not become another over-determined over-centralised solution imported from the OECD, where the jury is still out on how successful and indeed feasible it is.

52. Finally, a key element that requires attention is the development of cost accounting systems, which would provide information on expenditures by program activity in order to evaluate program cost benefit. Most low-income countries compile budget data by the usual IMF economic and

functional classifications, by detailed line item showing the type of expenditure (e.g. wages and salaries, civil works), and by administrative department responsible for the expenditure. Expenditure by programme is less likely to be routinely recorded. This makes it very difficult to identify expenditure by program without a revision of the public expenditure coding structure, which is a major exercise requiring several years to accomplish. The Bank discovered this when it began to implement the Loan Administration Change Initiative (LACI), whose Project Management Reports require the reporting of expenditure by program activity. Most countries have to make substantial changes to their cost accounting systems to comply with this requirement. This would be one of the problems to be overcome in moving toward performance management systems.

53. Bank/donor support for the development of M&E systems needs to be given much higher priority than it is now accorded.

Affordability

54. In most cases, the key constraint on the scope of a comprehensive program will simply be limited capacity to effectively utilize (and account for) resources. But in some cases there may be macroeconomic limitations (e.g., as may be true the Ethiopia sectoral programs), and as capacity constraints are overcome macro capacity will increasingly become a real issue. Budget support operations must be underpinned by careful analysis of the recurrent cost implications of the programs they are financing. Since adjustment instruments have not focused on expenditure programs this has not often arisen as an issue. As pointed out in the progress report on PRSPs, they are expected to integrate a fully costed poverty reduction strategy into a consistent macroeconomic framework. It should be anticipated that in most cases the PR programs presented will be overly ambitious, both from a capacity and fiscal perspective, but it will also be difficult to make objective judgments on this given the complexity of the linkages between macro policies and poverty reduction and the lack of reliable macroeconomic and poverty data. Care will have to be taken to ensure that PRSCs do not create fiscal problems.

55. Whether the projected fiscal gap is sustainable should be on the table in all PRSC discussions. The necessary analysis could fall within the scope of a PER or sector expenditure review. The key is the need for the PRSP to include a long-term perspective, to ensure that the expenditure programs being supported are consistent with:

- Long-term sustainability, based on realistic assumptions about the growth of domestic revenues and the longer-term access to foreign

capital. This implies a need for realism over future economic growth prospects, an issue which can be politically painful to address.
- Replicability, with social programs based on per capita expenditures, which are consistent with broadening coverage to reach virtually the entire population.

56. There is a danger that the medium-term perspective of the PRSP and of sector programs will ignore these longer-term issues. The problem has been recognized in the Uganda poverty eradication action plan, which has prepared longer-term scenarios to check the sustainability of the programs that are proposed. Though the future scenarios are highly uncertain, the task of estimating recurrent costs is perfectly achievable for the main spending sectors, provided the focus is kept on assessing the main cost drivers in the overall plan (e.g. numbers of teachers, kilometers of road to be maintained) rather than seeking to build up from project level, a level of detail which the center need not acquire.

Conditionality

57. The use of programmatic instruments to support a PRS or a CDF program poses a dilemma in regard to the application of conditionality, which has not yet been clearly addressed within the Bank. We can, however, derive guidance from experience with sector programs.

58. Since these instruments will be supporting expenditure programs they must be closely aligned with the budget. As Governments are encouraged to develop medium term expenditure programs, which depend upon donor financing, the risk to core expenditure programs if donor funds are not forthcoming is increased.

59. If agreed targets are to be met, resources must flow as planned. This means that, as noted above, disbursement must be delinked from policy conditionality. This should be handled by conditioning the operation on accomplishment of all policy reform essential to ensure that program targets for the phase being undertaken have been accomplished; that is, by applying ex ante policy conditionality. The conditionality that would apply during the disbursement period (which should coincide with the budget exercise) would be in regard to proper management of the program and progress on execution—(basically an input measure): have funds been spent on agreed purposes? Conditionality on fiduciary management would be essential; the program could be interrupted if standards were not maintained (e.g., if substantial misprocurement occurred).

60. Each programmatic instrument would be one of a series of operations, and there will have to be an annual review process to evaluate performance. That will be the basis for determining whether to proceed with the next tranche and how much that tranche should be. The annual review would have to consider program, policy and management performance: were funds spent as agreed; are output targets being accomplished; is the policy framework still sound and what more needs to be done; has management been satisfactory, particularly in terms of oversight of procurement and financial management systems, and execution and adjustment of the program taking into account information provided by the M&E system? Progress on the policy framework and outputs will have to be evaluated to identify course corrections needed to ensure that the program can achieve expected objectives. The basic principle is that key policy requirements are ex ante conditions, to be fulfilled before the first tranche is agreed; subsequent tranches will depend on ex post assessment of performance during the year, and of the adjustments made by Government in order to maintain progress towards the objectives. Failure to execute the programme as agreed would be the only condition which might result in interrupted disbursement during the implementation period.

61. The situation is not always so neat, however, when the perspective of a finance ministry managing a medium term budget process is considered. The Bank may think it is processing a credit based on an assessment of already completed reforms, but the lead time on budget preparation requires resource estimates some six months before the budget year, and there is clearly a chicken and egg situation in which Government needs to know what level of finance is available, and what reforms are required in order to release those funds. The subtle distinction that those assessments take place before loan approval does not in practice make much difference. Similarly, commitments for the following year will need to be made on the basis of budget and performance figures which may only cover the first quarter or so. Once Government and donors are embarked on a process of support to a medium term framework, the relationship becomes one in which progress and support are continually reviewed and adjusted in the light of available evidence, and one in which Government is basing its appeal for donor funds on an explicit or implied commitment to implement future reforms and to allocate resources to key priorities in the budget.

62. The assessment of performance is also complex. Countries may or may not implement the reforms and budget as agreed, and may or may not achieve the expected results. The extent to which measures are taken may say more about capacity problems or the need to bow to political influences, e.g. to get legislation passed, than any fundamental lack of

commitment. If reforms are implemented but do not achieve expected results, it is unreasonable to penalize. The one advantage of ex post conditionality is that it is easier to respond to these pressures than if over-determined tranche release conditions are violated.

Fiduciary standards

63. In a world in which fungibility is recognized as widespread, the Bank should draw little comfort from the application of strict fiduciary standards only to the expenditures that it directly finances. In all countries in which it provides significant funding, by whichever route, the bank should be interested in ensuring that Government implements policies and procedures to raise fiduciary standards to acceptable levels. Work is now advanced on defining fiduciary standards for traditional types of adjustment lending and for programmatic investment lending. The question being debated in the Bank is whether more exacting standards should be applied for programmatic lending that is designed to support expenditure programs. While both forms of lending do provide general support to the Government budget the key is whether a specific set of outputs and outcomes is expected, as in the case of a Poverty Reduction Program. If so, the need for fiduciary systems to help ensure that resources are used as intended so that these results can be achieved is important. Ultimately, however, irrespective of whether the support is for adjustment or for support of expenditure programs, the bank should link assistance to a requirement to build adequate systems to secure good stewardship of public funds.

64. The objective of any support should be to help build reliable national systems rather than substitute donor systems. Countries will have to put in place systems from the central level (e.g., budget management, auditing) down to the local or decentralized levels that ensure accountability and the proper use of funds. For most countries this means a thorough overhaul of financial management and procurement regulations and systems to ensure that satisfactory frameworks are in place, qualified staff are available and there is proper management and oversight.

65. The Bank has done a substantial amount of work on improving budget management on the basis of PERs and it is now launching an ambitious program of Country Financial Accountability Assessments and Procurement Assessment Reviews that would provide the basis for improving systems. But, as we have seen, there is a substantial gap in these areas. It is imperative for the move toward more comprehensive programs and instruments that this work is brought up to date. This,

however, is only part of the problem. This analytical work must be followed up on with programs for real institutional strengthening.

66. Such programs will take time to become effective so safeguards that give early warning of systems problems must be developed to manage the risks inherent in moving toward reliance on national systems. It would not be sufficient to rely on ex post audits, which may come six months or more after the fact. Expenditure tracking and sample transaction testing, particularly for procurement, as well as measures which test the effectiveness of management such as elapsed time on procurement steps can provide quick and useful information on how well systems are working and what kinds of improvements may be needed.

67. It is important that work on fiduciary standards takes a broader focus than the inputs and accounting issue. Accounts and audit will reveal expenditures not in line with official financial procedures, but can not in themselves detect abuses in the form of informal user fees, nor expenditures which, though properly vouched, have actually supported wasteful or corrupt spending. Service delivery, tracking of funds, and customer opinion surveys can help capture much of this.

Disbursement

68. The problems the Bank faces in regard to disbursement on programmatic investment instruments were outlined above. Unless there is a different interpretation of the Articles (which are not explicit on this point, particularly in the case of IDA) it will be difficult for the Bank to participate fully in pooling arrangements. It is not yet clear whether this will affect PRSCs—this depends on how they are viewed by the Board, but it does present problems for APLs and Sector Programs that aim to move toward greater harmonization.

69. The arguments against such participation are likely to be that it will be difficult to provide sufficient assurance that all program funds are being used for intended purposes and the political importance of being able to attribute Bank funds to specific expenditures. The approach now being considered within the Bank is to move forward with a number of pilots (e.g., Ghana Health) to demonstrate how the approach would work and how risks would be handled as a basis for presenting a fully developed proposal to the Board. It would, of course, be possible to use artificial attribution of expenditures, but this imposes an administrative burden on the borrower, which is precisely what pooling is intended to alleviate.

70. The normal mode of disbursement for a programmatic operation would be quarterly against expenditures from the agreed program. If all donor

funds were pooled in the budget each would initially advance an agreed percentage of the amount required, and this would be adjusted quarter by quarter based on actual expenditures[11]. The Bank would advance its share through a Special Account. The LACI disbursement procedure, using a PMR, is well suited to such an approach. It provides for quarterly disbursement based on actual expenditures and forecasts for the next quarter. In fact, the PMR could be greatly simplified for use with programmatic instruments as a number of reports such as procurement details could be eliminated.

Harmonization

71. The importance of having all partners providing foreign assistance harmonize their procedures is now accepted. For purposes of this note, the areas of harmonization include donor procedures covering fiduciary areas: procurement, disbursement, financial management, evaluations and evaluation systems. It also extends to the coordination of actions in appraising and supervising programs and the timeframe within which support is provided. Safeguard issues have not been dealt with.

72. A number of broad initiatives are underway (e.g., within the SPA in connection with Sector Programs and among Multilateral Development Banks, which includes harmonization of safeguard as well as fiduciary policies) and CDF countries have all initiated efforts toward greater harmonization. Progress in this direction, however, has been slow. Assuming a move toward programmatic instruments based on broad and co-operative donor participation, harmonization progress on substantive and, particularly, procedural matters will become a major issue.

73. It is universally agreed that the development of satisfactory fiduciary controls must be done within the country strategic framework and they must ultimately be imbedded in national systems. At the core of procedural issues are fiduciary requirements and the Bank and donors have their own imperatives. Where the harmonization effort has made progress, the sticking points have been on disbursement and procurement, as a consequence of rigidities within the Bank. There have been few, if any, difficulties in arriving at mutual agreement on harmonization of financial management or appraisal/supervision/evaluation procedures. The timing of provision of support has been a problem for some donors but there is a trend toward

[11] It need not be given as a percentage of the total. There is much to be said for donors setting their disbursement target in money terms, and thereby avoid amplifying shocks to the overall available finance. This does not imply a weakening of position, since the necessary sanction can always be delivered via a lower later commitment.

alignment with the budget cycle in the context of programmatic operations.

74. The disbursement issue has already been discussed. The major harmonization issue is the applicability of the Bank's Procurement Guidelines to programmatic operations. There are no procurement reviews in the case of "adjustment" operations—the only control normally is the use of a negative list. Programmatic investment operations, which involve the pooling of funds, are where problems arise. However, this has proven only to be the case for procurement under International Competitive Bidding.

75. The Bank's Guidelines are generally viewed as representing best practice and provide a good basis for development of national systems. The Guidelines provide for flexibility in the case of national-level procurement as long as the national system adheres to good practice. They also offer flexibility for community-based programs. In the cases where pooling arrangements have been successfully agreed, the participating donors have accepted the Bank's standards for national level—"below the threshold"—procurement, which does not require ex ante approval. The only issue in this case is whether the executing agency has the capacity to carry out the procurement properly.

76. Larger procurement packages that are likely to be bid internationally, however, do ordinarily require ex ante Bank approval. Here the Bank has little flexibility in modifying Guideline requirements, and other donors would have to accept them. Tying is a major problem for some bilateral donors and for MDBs whose memberships differ from those of the Bank. An additional possible problem is supervision of the process. The Bank might not be prepared to relinquish its "no objection" responsibilities or the right to make final decisions in the case of disputes. These issues have not yet been addressed, since experience in this area is too new. Of course, other donors also have rigidities but the Bank will find it very difficult to compromise on core fiduciary issues such as procurement.

77. For the time being, therefore, it is difficult to see how--under a programmatic <u>investment</u> operation--the Bank could participate in a pooled funding arrangement with other donors that covered procurement subject to international competitive bidding, if some participants had tying requirements that restricted opening the competition to all Bank member countries. Such procurement, however, could be taken out of the pool and handled separately. Members of the pool might also agree to assign to the Bank responsibility for providing ex ante approvals and resolving disputes. Although Bank policy on these issues is not likely to change, it is being tested. In the Mozambique Agriculture sector program, which

involved pooled funding, the staff is proposing that international competitive bidding be included and that the Bank restrict itself to ex post review. A reaction to this proposal can be expected in the coming months.

7. Priority areas for engagement with the Bank

78. The issues outlined above represent a distillation of the major problems apparent at this stage in the process of moving toward a comprehensive program approach. There has been no clear resolution of any of them and in some areas there is significant confusion within the Bank itself on how they should be resolved, or even whether they are issues.

79. DFID can play a useful role in this context since it supports the move toward comprehensive programs supported by programmatic lending. In the first instance, it should put these issues on the table for discussion with the Bank and other donors. Further it can be an effective partner with the Bank in improving the design of programmatic instruments and bringing other bilateral donors into the fold. Since there will be opposition within the Bank's Board to some of the design features of programmatic lending, DFID can be a useful advocate in support of this new approach.

80. To this end, DFID may wish to consider engaging the Bank on:

- Defining priority analytical areas needed to underpin comprehensive programs, a collaborative process for strategic selection of analytical work and using it to address capacity building requirements;
- Defining the rules of the game for the use of programmatic instruments—what to use in what circumstances to best address the capacity/resource transfer issue;
- Accelerating action on the development and installation of M&E systems;
- Evaluating the macroeconomic consistency of PSALs;
- Clarifying issues on the design of programmatic instruments;
- How it might best support the process of donor harmonization.

81. All of these issues should be on the table for discussion. The only questions on which the Bank might take the position that it has little flexibility are the easing of procurement requirements on ICB and breaking the link between disbursement and specific expenditures. These issues currently affect only programmatic investment lending and make it much less flexible and useful than should be the case. The disbursement link issue is one of interpretation. The Articles of Agreement (particularly for IDA) are not explicit and, arguably, the "intended purpose" test in the

Articles can be met more effectively through building country capacity to manage funds in a programmatic context than through tight controls. The Board, however, and particularly the US ED Office has been reluctant to see any loosening in this area and Bank management is not inclined to press the matter at present.

82. Programmatic adjustment lending is just now emerging and there is much confusion within the Bank on how it should operate and a real need to define the rules of the game. The key player here is the Operations Policy Staff (OPS) which sees this type of lending as the most feasible approach to supporting comprehensive programs given the limitations that would be presented by the application of Bank fiduciary and safeguard policies, which would be required for PERL –type instruments. The risks here are whether too loose an application of fiduciary safeguards would endanger achievement of the objectives of the operation and whether Bank Management and the Board would accept such a situation. The highest priority in respect of fiduciary safeguards is for the Bank to develop standards that could provide the basis for Board understanding and acceptance of a process of increasingly shifting to country-based systems. This matter is in the hands of Operation Core Services (OCS). Since such guidelines have not yet been developed for these instruments an answer is not likely to emerge until the first such operation—probably the Uganda PERC is presented for consideration later this year.

83. Under these circumstances we recommend that DFID take the follow positions on the suggested areas for engagement:

- **Analytical work and capacity building**: OPS is developing the new scenarios for sector work. The Board has already discussed its proposals informally and the next steps will be taken after the Development Committee meeting of September 25. The only relevant item for decision is whether the Board agrees that due diligence gaps should be filled. In discussions with Bank senior managers in this context, it would be useful to support a broader type of assessment as a basis for determining ESW requirements. Stress should be put on capacity building needed to support comprehensive program development and country rather than Bank leadership in determining priorities. The issue of appropriate "due diligence" requirements in the country context should be resolved in agreement with the country and participating donors. This would be a far more satisfactory approach than an ex ante Bank determination of requirements, and more likely to orient the agreed program to capacity building needs. It also would provide the basis for a more collaborative decision with the donors about division of responsibilities in providing support for such work. It should not be difficult to secure Bank agreement since this approach respects the principles of country leadership and partnership. The important point is that OPS provide clear direction to the Operations staff to ensure that this approach is implemented. It should provide some best practice cases (e.g., Jordan, Uganda) where this has worked well.

- **Instruments.** This is a critical area that will require a great deal more work with-in the Bank. DFID could play a useful role in ensuring that the right principles are applied in this process. Staff within OCS, which is responsible for overseeing fiduciary requirements, are likely to take a reasonable approach to the development of guidelines for the application of fiduciary requirements and understand the need to build capacity over time. They would support the need to address this issue clearly in the context of any programmatic operation. As noted, the operational staff involved in developing these instruments also wants to ensure that these issues are addressed. Avoiding this issue, however, would also mean avoiding the capacity building job necessary to develop sound national systems and thus would undercut the development impact of the programmatic approach.

  It would be very useful for DFID to press the Bank to develop as soon as possible clear criteria for the application of fiduciary and management requirements. This would be very helpful in putting the right issues on the table: how can the Bank best support comprehensive programs; what exactly are its fiduciary requirements for such programs; what is the best way of accomplishing its aims re fiduciary performance; what is the best process through which the Bank can test out systems for minimizing fiduciary and management risk?

  Once they are on the table there is a good prospect that they can be satisfactorily resolved over time. It would be particularly useful to develop the concept of the step-by-step capacity building process and how it should relate to program scope. This would help eliminate a double standard between investment and adjustment lending. In the case of the proposed small Benin PERC ($10m) objections were raised on management capacity grounds, while $45m in HIPC resources had been transferred with no conditionality. A compromise needs to be reached between the positions of little fiduciary requirements for adjustment lending and full application of fiduciary requirements that would be infeasible for most countries. If these issues are addressed more systematically, current operations that involve programmatic approaches such as the pooling of funds under sector operations or general expenditure program support could move forward with greater assurance that the rules of the game are clear. Until reasonable answers can be provided on this issue, there is likely to be little progress on developing true programmatic operations.

- **Monitoring and Evaluation.** It is welcome that the Bank is now embarking on a serious effort to strengthen M&E capacity both internally and for its borrowers. Each Region has been requested to select pilots and assign responsibility for managing the effort. It is important that the perspective of this effort be sufficiently broad to be useful. It must be oriented to improving overall public sector performance starting with the central agencies (i.e., finance and planning) and it must be a cooperative effort with the government and other interested donors within the framework of the move to a more comprehensive approach. The Operations Evaluation Department and OCS have the right perspective on this issue but it is unclear, given the ambiguity of the Working Group Report, whether the pilots will be well designed. Since this is to be a Regionally led effort the best approach for DFID would be to engage the Bank at the country director level, where pilots are to be undertaken. In addition, it might wish to express to management its concern as an involved donor in the importance of giving clear direction to the staff responsible for the design of the pilots.

- **Macroeconomic consistency.** This issue relates to the design of programmatic adjustment instruments—particularly PRSCs—and the major player on this in the Bank is again OPS. It is not clear from the relevant Bank documents that much consideration has been given to the impact of PRSCs on the long-term sustainability of PR programs, nor to how this issue might be incorporated into relevant sector work. It would therefore be useful for DFID to engage the Bank on this question and how it might be dealt with.

- **Design issues.** The issue of fiduciary standards has already been discussed. DFID can be helpful in engaging the Bank in a discussion of the best approach to handling conditionality under programmatic operations. It is not clear that the need for budget alignment, regular disbursement according to agreed plans based on program execution requirements and limited policy conditionality are fully understood in the Bank, since the tendency is to view these operations from the adjustment perspective. Again OPS must be engaged on this issue.

As suggested above, the issue of the link between disbursements and expenditures that is hobbling programmatic investment lending may be difficult to resolve at present because of management reluctance to deal with Board opposition to any change. This affects DFID's own programs (Ghana Health) and so it has a basis for directly engaging Bank management and pressing for a reasonable resolution. The Legal Department has been the principal advocate of a conservative position, but with new management in Legal there might be a chance of changing this view. It is unlikely that the Bank would currently be willing to broaden the scope of programmatic investment lending by moving forward with PERL-type operations, but sectorally-oriented programs will be severely restricted in their ability to provide strong support for comprehensive programs until this issue is resolved.

- **Harmonization.** The harmonization process is moving slowing on the ground. Here, DFID can be more helpful by engaging other donors than it can with the Bank. Most donors recognize the importance of harmonization, but have moved slowly to change their procedures. In some cases, they are restricted by law but there is generally more flexibility than recognized. The harmonization efforts in a number of Africa sector programs have demonstrated that there is a core of donors prepared to move forward on this issue and that the limited progress that has been made sends a strong signal to the more recalcitrant donors that they should show more flexibility. The leaders in this effort have been the EU, DFID, the Dutch, the Danes and Irish. France, after some reluctance has shown signs of willingness to change. Germany is restricted by a legal prohibition on funding recurrent expenditures. The U.S. and Japan have been the most reluctant to participate in harmonization efforts. DFID's active engagement on this issue might help convince other donors to loosen their procedural constraints.

  The Bank's rigidities that have hampered harmonization efforts, despite operational staff willingness are the disbursement link, which prevents full pooling and restrictions pertaining to the ICB process. On the former, DFID can help as suggested above. The latter issue will take some time to resolve and to the extent that the Bank requirement that all procurement be open to all its members conflicts with the tying requirements of other donors, it cannot be resolved. However this mainly affects other multilateral development banks. It does not eliminate the possibility of pooling funds. It simply means that purchases made through ICB might have to be kept out of the pool.

84. To the extent that DFID can engage the Bank (and other donors) in these issues and can help push in the right direction it could make a significant contribution to moving the CDF and PR program agenda forward.

Annex 1: World Bank Programmatic Instruments

Lending Instruments	Objectives	Phasing	Macro policies	Management capacity	Other requirements	Conditionalities	Disbursement
1. Investment							
Sector Invest. & Maintenance (SIM)	Support for sectoral public expenditure program, including both capital and recurrent expenditures.	Normally 4 – 8 years, no tranching	Satisfactory macro policies and performance	Good sectoral mgmt. capacity should be in place and strengthened under the program.	Good donor coordination; satisfactory sector policy framework and program; local ownership and participation	Maintenance of satisfactory macro and sectoral policy framework and performance	Against specific expenditures
Sector Programs (varient of the SIM; also known as Sector Investment Program or SIP)	Same	Same	Same	Satisfactory program to build management capacity and risk control measures until performance satisfactory	Same	Same	Against specific expenditures; proposals to disburse into a pool of donor funds under consideration
Adaptable Program Loans (APL)	Support for long-term sectoral or other thematic program (e.g. environment).	Commitment to support a long-term program with a series of 2-3 year operations; subsequent operations committed if policy and performance commitments are met.	If program covered by APL is likely to be affected by macro performance, this may be a condition.	Management capacity building can be addressed in early phases of the APL.	Same	Satisfactory program policy and implementation performance; satisfactory macro performance if relevant.	Same
Public Exp. Reform	Budget support	May be a	Satisfactory	Initial	Acceptable	Satisfactory	Disbursement

Lending Instruments	Objectives	Phasing	Macro policies	Management capacity	Other requirements	Conditionalities	Disbursement
(PERL—not a formal Bank instrument so no formal requirements established)	for entire medium-term expenditure program.	multi-year program with annual tranche based on performance	macro policy and performance; good budget management	management capacity strong enough to ensure funds will be used for intended purposes. Strong capacity bldg program	medium-term expenditure framework (MTEF) that fits macro program; good donor coordination; local ownership and participation	macro and sectoral policy/performanc e; effective management of MTEF based on Monitoring and evaluation system	against expenditure program performance in line with budget requirement. Funds are pooled in budget so do not disburse against specific exp.
2. Adjustment							
Structural or Sector Adj.	Quick disbursing support to fill balance of payments gap.	Single operation that may be for 1 or more years; may have single or multiple tranches, including floating tranches	Satisfactory macro policies/perfor mance	No specific requirements related to management of funds aside from those incorporated in specific conditionalities	None	Conditionalities normally relate to satisfactory macro performance and policies that promote growth, improve public sector management, trade policy, resource mobilization, private sector development and sectoral performance in some cases.	Disbursement normally governed by a negative or positive list of imports. Tranches disbursed based when policy conditionalities met
Programatic Sector Adj.(PSAL)	Same	Commitment to support a medium term program of	Satisfactory macro policies/perfor mance	Policy still being formulated but it is likely that there will be some	Satisfactory progress on policy reform and institution	Same	Same. Tranches spaced regularly throughout year and tied to specific

Lending Instruments	Objectives	Phasing	Macro policies	Management capacity	Other requirements	Conditionalities	Disbursement
		policy reform with 1 year operations over a 3-5 year period; subsequent operations if policy and perfomance commitments are met.		requirements for improved public sector management to ensure MTEF execution.	building. Emphasis on public sector management, governance, resource allocation and public service delivery. It is likely that satisfactory MTEF will be required		target measures.
Poverty Reduction Support Credit (PRSC). This is a form of PSAL.	Same although there may be some link to execution of the poverty program as defined in the PRSP.	Same.	Satisfactory macro policies/perfor mance; satisfactory poverty reduction program as incorporated in PRSP.	Same re PRSP.	Link to execution of PRSP not clear.	Same; disbursement link to PRSP not clear at this time.	