

Comments on “Caribbean Development Bank: Policy-Based Lending and its Evaluation”

Comment by: Ali Khadr

The chapter provides an informative overview of the findings of five assessments, including two Office of Independent Evaluation (OIE) evaluations, of Caribbean Development Bank (CDB) policy-based operations (PBOs). Among many other findings, it conveys clearly how the institution’s practice of policy-based lending (PBL), as well as the associated framework and guidance, has evolved over the roughly 15 years since it was officially initiated. Like other multilateral development banks (MDBs), CDB has moved over time toward the body of good practice identified in an ever-growing PBL literature. As expected, the favorable evolution of CDB’s PBL practice notwithstanding, there is room for further improvement.

Among the key elements of this emerging body of good practice are: (i) more frequent use of the more adaptable programmatic PBL instrument variant compared with the more rigid multitranche variant; (ii) a focus on fewer, “deeper”¹ prior actions in PBOs; (iii) use of results frameworks with a tighter logic linking a limited number of prior actions to a manageable number of key outcomes sought, as well as associated use of specific, measurable, achievable, relevant, and time-bound (SMART) results indicators; (iv) greater country ownership of proposed measures and outcomes sought, bolstered by broad prior consultation; (v) identification of capacity constraints to reform implementation and provision of parallel technical assistance as needed; and (vi) identification and mitigation of risks that are adequately tailored to the specific operation.

There is little I can find to disagree with in the chapter’s chronicling of the findings and recommendations of the successive reviews and evaluations of CDB policy-based lending. There is also little I find counter-intuitive in the findings. I propose therefore to focus this commentary on a few questions that future CDB evaluation work on PBL might usefully look at in greater depth (existing OIE work has already examined them to some extent). These questions concern: (i) the use of PBOs specifically as they relate to small states and the shocks to which they are frequently subject; (ii) the use of PBOs to strengthen fiscal management; (iii) analytical underpinnings of PBOs; (iv) results framework quality, including depth of prior actions; and (v) establishment of attribution or contribution.

¹ The concept of depth, which has been used in several evaluations of policy-based lending, can be traced back to the measure of “structural depth” developed and applied in IEO (Independent Evaluation Office), 2007. *Structural Conditionality in IMF-supported Programs*, Washington, D.C.: International Monetary Fund.

1. Policy-Based Operations and Small States

CDB is unique among MDBs in that its clients consist overwhelmingly of small states, formally defined as countries with fewer than 1.5 million inhabitants. Of the CDB's 19 borrowing member countries (BMCs), 17 are small states (or dependencies). Of the latter, most are islands or archipelagos.

As has been extensively documented in a burgeoning literature, small states as a group, and especially small island states—despite the heterogeneity of their specific characteristics and needs—share several intrinsic characteristics and challenges compared with larger states.² These include fixed costs in the public and private sector that are typically high relative to the small scale of operations, entailing high unit costs (and, for instance, larger public expenditure, including public sector wage bills, as a share of GDP). The locations of these states also commonly entail high trade costs as well as extreme vulnerability to natural disasters and the deleterious effects of climate change. In addition, their exports tend to be very concentrated (e.g., in tourism and a few commodities), which makes them particularly vulnerable to trade shocks and contagion from trading partner downturns, including the downturn that the coronavirus disease (COVID-19) pandemic has induced. In addition, the small absolute (though not relative) size of their public sectors limits their institutional capacity for policy making and service delivery.

These intrinsic characteristics and challenges, particularly the exposure to repeated economic and natural shocks that are large relative to GDP, have resulted in a greater volatility of growth in small states compared with larger states. Together with the inherent stresses on public finances and limited borrowing opportunities, these repeated shocks have often entailed fiscal distress and rapid debt accumulation, making effective fiscal and debt management an imperative.

Given the shock-intensive client country context, policy-based lending from multinational development banks has a clear role to play in CDB BMCs. It is especially encouraging to see that CDB has stepped up to the plate, *inter alia* raising the prudential limit to 38% to create lending headroom to counter COVID-19-related fallout and offering exogenous shock response policy-based operations (PBOs) as a distinct instrument variant. Future evaluations of CDB PBOs can yield valuable lessons on how effectively such operations have supported small states, especially in helping to mitigate the shocks to which they are subject and to build resilience. In particular, it may be worth examining whether: (i) in seeking to strengthen fiscal resilience, the PBOs have been sufficiently broad in scope, adequately addressing the multiple drivers of fiscal and debt sustainability; and (ii) in seeking to enhance natural disaster and climate change resilience, the PBOs have gone beyond direct support for resilience-building and focused on measures that can foster wholesale changes in public and private incentives and behavior as well as on the long-term risks of climate change (including whether they have facilitated countries' access to climate financing).

2. Policy-Based Operations and Fiscal Management

² See, for example, Independent Evaluation Group. 2016. *World Bank Group Engagement in Small States: The Cases of the OECS, PICs, Cabo Verde, Djibouti, Mauritius, and the Seychelles*. World Bank Group: Washington, DC. IEG's cluster country program evaluation of World Bank Group support to small states found a repeated two-pillar pattern of country program support in these countries: (i) for strengthening resilience (macro-fiscal, disaster risk and climate, and social); and (ii) for enhancing competitiveness (trade facilitation, financial sector strengthening, infrastructure expansion and management, and leading sectors (e.g., tourism, fisheries, and agriculture) support). The evaluation assessed the World Bank Group programs in the six independent Organisation of Eastern Caribbean States (OECS) countries and nine Pacific island countries, and more selectively the programs in four African small states: Cabo Verde, Djibouti, Mauritius, and Seychelles. It covered the period 2006–2014.

In keeping with the findings of IEG (footnote 179) and those reported in the chapter, it is likely that in many small states drawing on PBOs, fiscal management will be—or at least should be—a central component. This observation suggests that one area of focus in future PBL evaluation work by CDB could usefully be the quality of PBOs’ macro-fiscal frameworks, given recent findings in the evaluation literature to the effect that it is positively associated with loan outcomes.

In an earlier study, IEG examined the quality of macro-fiscal frameworks in 390 World Bank PBOs completed during fiscal years 2005–2013 and found that certain aspects of the quality of PBO macro-fiscal framework design were positively correlated with loan outcome ratings.³ Specifically, two aspects of the quality of the PBO framework showed a statistically significant association with loan outcome ratings: (i) the credibility of the PBO framework given the country’s fiscal track record; and (ii) adequate coverage of quasi-fiscal risks (i.e., risks that the government might need to devote public spending to off-budget items, such as an underfunded public pension system or state-owned enterprises in distress). Once PBO implementation quality—as measured by the deviation between the macro-fiscal targets under the PBO and actual outcomes—was factored in, the overall quality of macro-fiscal framework design was also statistically significantly associated with loan outcome ratings. The quality of framework design was also positively correlated with PBO implementation. Moreover, in-depth case studies suggested that close collaboration with the IMF in PBO preparation increased the likelihood of a well-designed macro-fiscal framework.

In this regard, I was not entirely clear from the CDB chapter whether the OIE evaluation of PBOs examined the quality of collaboration with the IMF in developing and monitoring the associated macro-fiscal frameworks. Given the requirements under the 2013 framework, intuition suggests at least some level of collaboration, but future evaluation work could usefully assess the depth of such collaboration, and whether it correlates to PBO effectiveness.

3. Analytical Underpinnings of Policy-Based Operations

There is emerging, although not entirely conclusive, evidence that strong analytical foundations can be an important determinant of PBO effectiveness. For instance, IEG found generally solid links between World Bank PBL design and integrative analytical work on public expenditure, as well as continuity in policy dialogue from the latter to the former.⁴ However, it was difficult to establish a clear association between such links and PBO outcome ratings, although PBOs informed by analytical work on public expenditures showed slightly better outcome ratings over 2009–2012. Nevertheless, case studies did provide illustrations (e.g., a programmatic PBL series in Peru) where timely, high-quality analytical work informed loan design, including the choice of prior actions and the specification of robust links between actions and anticipated outcomes in the results framework, resulting in good loan outcomes.⁵ Findings regarding the importance of sound analytics are also reflected in earlier evaluation work, notably an evaluation at the Asian Development Bank in 2007, which found that insufficient consideration of macroeconomic and/or sector policies tended to detract from desirable loan outcomes.⁶

³ Independent Evaluation Group. 2015. *Quality of Macro-Fiscal Frameworks in Development Policy Operations*. Washington, DC: World Bank.

⁴ Independent Evaluation Group. 2015. *How does Knowledge on Public Expenditures Integrate with the Design of Development Policy Operations?* Washington, DC: World Bank.

⁵ Case studies also pointed to instances of missed opportunities where available knowledge was not adequately drawn upon and loan outcomes were compromised.

⁶ Operations Evaluation Department. 2007. *Policy-Based Lending: Emerging Practices in Supporting Reforms in Developing Member Countries*. Manila: Asian Development Bank.

In this regard, I was not entirely clear from the CDB chapter whether the OIE evaluation had systematically assessed whether PBOs were adequately underpinned by analytical work, although this would be a worthwhile topic for future CDB evaluation work to examine.

4. Policy-Based Operations Results Framework Quality and Depth of Measures

It is encouraging to note from the chapter that the depth of prior actions in CDB PBOs has increased over time. Depth of a prior action—the extent to which the reform measure on its own can bring about lasting change in the institutional and policy environment—is a key ingredient in the quality of the results framework.⁷ In other words, non-critical, shallow, and process-related measures should be avoided. Another key ingredient in quality of the results framework is the consistency of the policy matrix—the extent to which there is a clear “line of sight” between PBO conditions, program objectives, and the intended results or outcome indicators. In other words, there should be a strong logic linking inputs, outputs, and outcomes, including in the results indicators selected.⁸

Because there is some empirical evidence that these two aspects of the quality of the PBO results framework matter to loan outcomes, they would be worthwhile areas of focus in future PBL CDB evaluation work. Moll et al. used regression analysis to examine the correlates of the outcomes of World Bank PBOs.⁹ They focused on two variables, both constructed through desk reviews of the PBO documentation. The first was the fraction of “weaker” prior actions that focused largely on process-oriented steps—in other words, that lacked depth. The second variable measured the extent to which the results framework embodied a clear link between PBO conditions, program objectives, and the intended results, including the use of specific, measurable, achievable, relevant, and time-bound (SMART) indicators. The paper found that the second variable had a strong and statistically significant positive association with the PBO outcome rating. The first variable, the proportion of prior actions lacking in depth, was negatively associated with the PBO outcome rating, and its significance increased once the variable on policy matrix consistency was removed from the model. In summary, a clear link from reforms to outcomes and a lower proportion of conditions lacking in depth were both associated with a better outcome rating.

5. Attributing Outcomes to Policy-Based Lending

A common complaint in PBL evaluations concerns the difficulty of attributing—at least in part—medium-term country outcomes to the use of PBOs, including the prior actions they support and the

⁷ Independent Evaluation Group. 2015. *The Quality of Results Frameworks in Development Policy Operations*. Washington, DC: World Bank. OIE’s evaluation of PBOs in the Organisation of Eastern Caribbean States (OECS) countries in the CDB chapter found 25% to be low-depth, 48 medium-depth, and 27% high-depth, and in programmatic series, high-depth prior actions were observed in the later loans. IEO (Independent Evaluation Office), 2007, *Structural Conditionality in IMF-supported Programs*, Washington, D.C.: International Monetary Fund, found that depth was often lacking in IMF structural conditionality. Similarly, the Inter-American Development Bank, OVE (Office of Evaluation and Oversight. 2016. *Design and Use of Policy-Based Loans at the IDB*. Office of Evaluation and Oversight Technical Note to the 2015 Annual Report, Washington, DC: Inter-American Development Bank) found that most reform measures in a sample of IDB PBOs were low- or medium-depth, although the depth of the reforms tended to increase in later operations in a programmatic series (which also implied that truncation of series, frequently observed, missed out on the more worthwhile reforms). IED (Independent Evaluation Department, 2018) *Policy-Based Lending 2008–2017: Performance, Results, and Issues of Design*, Asian Development Bank, Manila, also documented the frequent absence of depth in ADB PBO-supported measures.

⁸ This also implicitly takes account of how well the results indicators selected fulfill the SMART criteria.

⁹ Loan outcomes were measured by the IEG-validated performance (or outcome) ratings of 312 PBOs completed between 2004 and 2015. P. Moll, P. Geli, and P. Saavedra. 2015. Correlates of Success in World Bank Development Policy Lending. *Policy Research Working Paper 7181*. World Bank.

financing they provide. The difficulty is compounded when several development partners deliver PBL simultaneously. It is therefore not surprising to read in the chapter that “it was not feasible for the [OIE] evaluation to gather a sufficient amount of directly attributable evidence to support statements of causal linkage between CDB’s PBL support and higher-level medium-term outcomes.”

Nevertheless, it is often possible to make some headway, perhaps toward establishing “plausible likelihood of contribution” (rather than directly attributing an outcome to a PBO), and future CDB evaluation work might usefully focus on this. The process involves—for PBOs with reasonable-quality results frameworks—referring to an evaluation framework such as that prepared by OECD.¹⁰ My own preference involves doing a “right-to-left” or “reverse causal chain” analysis using the PBO’s results framework, involving the following sequence of steps:

- clearly state the outcome(s) that is (are) the subject of the causal contribution analysis, including the associated outcome indicator(s);
- identify the main factors that play a role in bringing about the outcome(s) and changes, including the contributing policies, the outputs of public and private expenditures, and the supporting institution(s);
- identify the principal roles that the CDB and other development partners have played in enabling these contributing factors; and
- following the logic of the results chain, identify the concrete elements of the PBO—including the relevant prior actions, the financing provided, and any associated policy dialogue, analytical work, technical assistance, and convening activity and partnerships engagement—that have been the principal means through which the PBO has helped enable the contributing factors.

6. Conclusion

Given the concentration of CDB clients in small states, CDB PBL evaluation work can teach us valuable lessons about how CDB PBOs support small states in dealing with shocks, particularly whether PBOs adequately cover the multiple drivers of fiscal and debt sustainability and whether they foster systemic, rather than incremental, changes in disaster and climate resilience by targeting incentives and behaviors. Other questions on which future CDB evaluation work could usefully focus include: the quality of CDB PBOs’ macro-fiscal frameworks and analytical underpinnings, the quality of PBO results frameworks (including depth of prior actions supported), and establishment of the plausible likelihood of PBOs contributing to country outcomes.

¹⁰ Organisation for Economic Co-operation and Development. 2015. *Evaluating the Impact of Budget Support: Conclusions and Recommendations Based on a Synthesis of Seven Budget Support Evaluations*. Paris: OECD.