EXECUTIVE SUMMARY

This report is the fourth Retrospective of Development Policy Financing, one of the World Bank’s three financing instruments. Development Policy Financing (DPF), the Bank’s general budget support instrument, aims at helping clients achieve sustainable growth and poverty reduction through the support of a program of policy and institutional actions. Development Policy Financing is provided in the form of non-earmarked loans, credits, grants or policy-based guarantees.

Since its introduction over 10 years ago, Development Policy Financing has proved to be a robust and flexible instrument that supports a diverse set of clients. DPF supports a wide range of countries, including middle-income countries such as Turkey and low-income countries such as Madagascar. The reforms supported cover a broad spectrum, from disaster risk management to fiscal reforms, and to social safety nets, in line with the countries’ priorities. With a view to enhance the performance and effectiveness of the instrument, adjustments have been made over time to the operational policy and guidance, including measures to strengthen country ownership, reduce excessive conditionality and strengthen the results focus. Changes have also been made to facilitate the use of DPF at the subnational level; as a contingent financing source, including for natural disasters; and in the form of policy-based guarantees that leverage private sector financing for development.

In line with the 2013 World Bank Group Strategy, this Retrospective focuses on how reforms supported by Development Policy Financing contribute to equitable growth and poverty reduction, taking into account environmental, social and economic sustainability. The WBG has set ambitious goals to (i) end extreme poverty by reducing the percentage of people living on less than $1.25 a day to 3 percent by 2030; and (ii) promote shared prosperity by fostering income growth of the bottom 40 percent of the population in every country. The Strategy also emphasizes the WBG’s commitment to support countries achieve these goals in a sustainable manner. With this in mind, the 2015 Retrospective focuses on three key questions: (i) how are countries’ policies supported by DPF aligned with poverty reduction and shared prosperity?; (ii) how successful have Development Policy Operations (DPOs) been at achieving their intended results, and have the results been sustained?; and (iii) to what extent do countries’ development reforms supported by DPF account for environmental, social and economic sustainability?

To help answer these questions, this Retrospective reviews all operations approved since the last Retrospective: that is, all operations approved between April 2012 and December 2014, which corresponds to 165 DPOs and two supplemental financing operations. Of these, 77 were IBRD-financed (or IBRD/IDA blend), 83 were IDA-financed (or IDA/TF blend) and five were solely financed by trust funds (TFs). In addition, the Retrospective analyzes the main trends in the provision of DPF in the 10 years of the instrument. This Retrospective has also benefitted from the lessons learned from four learning products prepared by IEG.

DPF accounts for roughly one-quarter of total Bank lending. Over the last 10 years, the Bank has approved 630 Development Policy Operations and 22 supplemental financing operations, representing approximately $117 billion worth of commitments. In the context of supporting recovery from the global financial crisis (FY09-10), DPF commitments as a share of total Bank lending reached nearly 40 percent, up from 25 percent in FY07. The share of DPF has

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1 The instrument was introduced in FY05 when OP8.60 on Development Policy Lending became effective. With the reform of the World Bank’s operational framework on guarantees, Policy-Based Guarantees were incorporated into OP8.60 and the instrument was renamed Development Policy Financing.
2 "Environmental, social and economic sustainability require action to secure the future of the planet, ensure social inclusion, and set a solid foundation for the well-being of future generations” (page 5, WBG Strategy).

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steadily been returning to more normal levels since FY12 and stood at slightly less than one-quarter of total Bank lending in FY15. AFR dominated in terms of the number of DPOs (222 approved operations), whereas LCR absorbed the largest share of DPF commitments (31 percent of the total). The DPF share in total IBRD commitments spiked to 47 percent in FY09 at the onset of the global financial crisis and it represented about 31 percent by end-FY15, largely reflecting economic recovery in middle-income countries. The share of DPF in total IDA commitments, however, has been steadily declining since FY08 and is now at 14 percent (FY15).

**DPF performance throughout the 10-year period has been strong, meeting or exceeding corporate scorecard targets.** The share of exits rated moderately satisfactory or above, as evaluated by IEG, has consistently been at or above 75 percent. This strong performance has been supported by notable improvements over the years in the quality of the results frameworks as evidenced by a reduction in the average number of results indicators (with greater prioritization and selectivity), as well as a significant increase in the use of well-defined indicators with baseline and target values. The analysis conducted by IEG in the context of the learning product “The Quality of Results Frameworks in Development Policy Operations” corroborates this finding.

**DPOs achieve their intended results and preliminary analyses suggest that these results are largely sustained.** Early findings based on a pilot study provide evidence that the bulk of public financial management reforms supported by DPF are sustained for several years beyond the period typically covered by the ICR or IEG evaluation. This is an important finding as a large share of the reforms supported by DPF pertains to public financial management. A second analysis shows that macroeconomic policy reforms supported by DPF have resulted in sustained improvements in the quality of economic policy, as measured by the relevant CPIA scores. A third and critical source of evidence is provided by selected Project Performance Assessment Reports (PPARs) prepared by IEG.

**The Bank remains selective in the number and type of prior action it supports through DPF.** The average number of prior actions per DPO is eight, down from 11 in FY05. At the same time, there has been a gradual shift in the reform content of prior actions supported by DPF: reforms in the area of public sector governance continue to dominate, but their share is decreasing, making way for more prior actions in the area of financial and private sector development and trade, as well as social development and social protection. This suggests an overall shift away from “first generation” reforms, which often centered on public financial management, towards “second generation” measures, many of which are related to improving the investment climate, strengthening competitiveness and improving social safety nets. Furthermore, within various DPF supported themes there is a shift from “nuts and bolts” types of prior actions to more advanced reforms over time. Program Documents consistently discuss the analytical underpinnings informing the operations, and a large majority show clear links between individual prior actions and the findings of the underlying analytical work.

All prior actions are intended to contribute to poverty reduction and shared prosperity in the medium to long term. Prior actions supported by DPF are aligned with the corporate goals through their impact on growth that allows for high levels of participation by the bottom 40 percent. Using the conceptual framework of this Retrospective, this impact takes place through a number of transmission channels which affect assets, the return to assets and intensity of use, and access to finance. However, many DPOs also have positive poverty or social effects that can be directly attributed to the reforms supported. These include the 264 operations approved since 2005 supporting reforms in social protection, labor and social development. Of the prior actions analyzed within this Retrospective period, 16 percent are likely to have significant positive poverty, social or distributional effects.

**DPF has also supported many reforms directly targeting environmental sustainability.** Since 2005, 142 DPOs (about one-quarter) had at least one prior action on environment and natural resources, and 21 operations supported measures related to climate change. However, when considering the share of prior actions in these areas among all prior actions supported during the Retrospective period, 80 percent of prior actions are not likely to have significant effects, and only about 9 percent are likely to have significant positive effects on the environment. There is demand for more intensive use of DPF in support of policy and institutional reforms related to environmental sustainability and climate change adaptation or mitigation.
Only a small share of prior actions is likely to have significant negative poverty/social or environmental effects. The operational policy requires an analysis of poverty/social and environmental effects associated with DPF supported reforms to ensure that potential adverse effects are properly assessed, and for a discussion of the country systems to mitigate such effects. The independent review conducted for this Retrospective showed that an estimated 4 percent of prior actions could potentially have negative poverty or social effects. These include prior actions supporting energy tariff reforms, tax reforms and other measures that in the long run are expected to contribute to higher growth, which in turn would be expected to benefit the poor. Poverty and social impact assessments were conducted for 73 percent of prior actions with potential negative effects, up from 54 percent in the last Retrospective. In the case of the environment, only an estimated one percent of prior actions is likely to have significant negative effects, including reforms related to agriculture, oil and gas, trade and competitiveness and infrastructure. However, the discussion of the effects was adequate in only one-third of these prior actions. Furthermore, in 6 percent of all prior actions, Program Documents did not provide sufficient information to allow for an assessment of the likely effects. This suggests that the implementation of the environmental and social requirements of OP8.60 needs to be strengthened further.

In December 2013, the Board approved a major reform of the World Bank’s operational policy framework on guarantees, which became effective on July 1, 2014. The reforms included the mainstreaming of guarantees into the operational policy for Investment Project Financing (IPF) (in the case of project-based guarantees) and DPF (in the case of policy-based guarantees). As a result, guarantees are no longer treated as a separate instrument, but rather as an alternative source of financing for investment projects or development policy operations. In addition, with these reforms, policy-based guarantees have become available to some IDA countries at low or moderate risk of debt distress.

Another critical reform, introduced in October 2014, is the Systematic Operations Risk-rating Tool (SORT). This new tool (i) systematically and consistently rates the risks of operational and country engagements in all regions and across all operations (IPF, DPF, and soon PforR); (ii) helps focus management attention on high and substantial risk operations and on particular risks within operations during implementation; and (iii) provides a light but systematic and contestable way of identifying the appropriate level of corporate review process and need for Board discussion. The SORT also applies to Country Partnership Frameworks (CPF). Preliminary data suggests differences in the risk profile of DPOs in different regions and different client segments.

The reform introduced to the Deferred Drawdown Option (DDO) appears to have yielded results, with an uptake of 15 DPOs with DDO since 2008. Recent changes in the financial terms of regular DPOs vis-à-vis DPOs with DDO stress the importance of appropriate pricing of financial options (to the extent that they take up lending space on the Bank’s balance sheet). In January 2012, a stand-by fee of 0.50 percent per annum on undrawn balances was introduced for DPOs with DDO and, in February 2014, the Bank reinstated a 0.25 percent per annum commitment fee on undisbursed balances of normal IBRD loans.

In addition, since the introduction of the Deferred Drawdown Option for catastrophic risk (Cat DDO) in 2008, 11 DPOs with Cat DDO have been approved. To date, no country has chosen to use the revolving feature. One country has opted for closing and requesting a new DPO, rather than using the revolving feature. Most loan amounts are near the maximum allowed under the policy, that is, close to 0.25 percent of GDP, which suggests that the limits set in 2008 are a binding constraint and may need to be reconsidered. All DPOs with a Cat DDO focused on reforms to enhance the government’s capacity to implement its disaster risk management programs. Significant challenges related to monitoring and evaluation have arisen as teams prepare the first ICRs, given that DPOs with Cat DDO can be renewed up to four times.

4 Revolving feature allows amounts repaid by the borrower to be available to them for drawdown, provided that the closing date has not expired.
2015 Development Policy Financing Retrospective – summary of proposed measures

**Overarching measures**

**Further improve DPF performance through corporate support and TTL accreditation.** In order to ensure that staff working on DPF have the required skills and knowledge to prepare high quality operations, OPCS will complete the roll-out of a new DPF-specific TTL accreditation system and make participation in the DPF Academy mandatory for all new task team leaders.

**Complete the roll out of the new Systematic Operations Risk-Rating Tool (SORT).** SORT will be rolled out to all new DPOs (including new operations in ongoing programmatic series). To ensure that all DPOs consistently and systematically assess risk, the mandatory nature of SORT will be clarified in the DPF procedures.

**Measures to modernize DPF options**

**Update rules governing DPOs with DDO and Cat DDO.** Treasury, Credit Risk and OPCS will work together with Global Practices and Regions to review options to (i) limit the number of renewals and review the revolving feature of Cat DDO; (ii) allow for a “top up” and changes to the program at renewal, and raise the US$500 million limit for Cat DDO; (iii) clarify the definition of “natural disasters” which may trigger a Cat DDO disbursement; and (iv) separate the timeframe for program evaluation from the lifespan of the financial option for both DDO and Cat DDO.

**Measures to strengthen implementation of environmental and social requirements**

**Comprehensive revision of staff guidance on environmental effects.** The Environment and Natural Resources GP and OPCS will work together with other parts of the Bank to thoroughly revise the existing toolkit and staff guidance on assessing environmental effects of DPF-supported prior actions. The revised guidance will be incorporated into the DPF Academy and other relevant training events.

**Introduce a new environmental and social effects screening table in DPF Program Documents.** OPCS will include a mandatory table in the Program Document template that will ensure and facilitate a more systematic and transparent screening of prior actions for likely social and environmental effects.

**Further support social and environmental analyses.** Together with other units, OPCS will explore ways in which greater support could be made available to help pilot approaches to analyzing social and environmental effects and disseminate good practices.

**Strengthen internal review processes for environmental and social effects.** OPCS will continue to maintain a DPF corporate support team, which will review DPOs at concept and decision stage, taking into account the findings of this Retrospective. As an enhanced input to this process, OPCS will strengthen its in-house capacity to undertake due diligence reviews of environmental and social effects.

**Strengthen the focus on social and environmental side effects in program evaluations within agreed boundaries of responsibilities.** OPCS will work with IEG to identify ways in which ICRs could better account for any social or environmental effects of DPF-supported policies that may occur between Board approval and completion reporting.