2021 DEVELOPMENT POLICY FINANCING RETROSPECTIVE
FACING CRISIS, FOSTERING RECOVERY

EXECUTIVE SUMMARY

1. **This report is the fifth Development Policy Financing (DPF) Retrospective.** DPF, one of the Bank's three complementary financing instruments, is non-earmarked budget financing that supports policy and institutional reforms to help clients achieve sustainable growth and poverty reduction. The Bank has periodically reviewed the trends and performance of DPFs, with a view to strengthen its relevance as a financing instrument for Bank clients. This Retrospective presents key takeaways on trends and performance of DPFs and their role in supporting development priorities. The analysis is focused on DPFs committed between July 2015 and June 2021 (the "Retrospective period").

2. The Retrospective period was a tumultuous one for many developing countries. These years started with the aftermath of the commodity bust and ended with the COVID-19 pandemic. During this period, there were rising concerns and awareness of the need to address the detrimental effects of climate change, social and gender inequities, frequent natural disasters and other shocks, insufficient quality jobs, and persistent debt vulnerabilities, especially in low-income countries. The period culminated with the unprecedented COVID-19 pandemic, the impacts of which on reversing development gains are far reaching and ongoing, with intensified risks to the WBG twin goals. In this context, DPFs played a key role for reinforcing foundations for long-term development, crisis response, and preparedness, in complementarity with other WB instruments, working with IFC and MIGA, as well as other development partners, in support of countries' efforts to address these issues.

3. The Retrospective also takes place in the context of core corporate commitments made by the Bank Group during the period. The IBRD Capital Package, the 18^{th} and 19^{th} IDA replenishments translated the 2016 Forward Look objectives into implementation.[1] The need to leverage resources for development, combined with rising debt vulnerabilities across WBG client countries brought out the importance of domestic resource mobilization, debt and fiscal sustainability, while the role of the private sector was recognized as central to support economic growth and jobs, as reflected in the Private Capital Mobilization (PCM) and Jobs and Economic Transformation (JET) agendas. Serving all clients meant scaling up support to lower income IBRD countries (especially those that recently graduated from IDA), while at the same time continue to engage with clients across the income spectrum. The Forward Look noted that the WBG would "take on an expanded role in addressing global public goods, including working on (…) climate change, and major outbreaks of diseases" and embraced crisis management and gender equality as key priorities. This report looks back to analyze how DPF was used to implement these important priorities. Looking ahead, it sheds light on how the instrument can be enhanced to support the newly endorsed WBG Green, Resilient, Inclusive Development (GRID) approach.

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[1] https://thedocs.worldbank.org/en/doc/545241485963738230-0270022017/original/DC20160008.pdf.
https://www.worldbank.org/en/news/press-release/2018/04/21/world-bank-group-shareholders-endorse-transformative-capital-package
https://ida.worldbank.org/replenishments/ida18-replenishment
https://ida.worldbank.org/replenishments/ida19

4. **The Retrospective examines the performance of DPFs over the Retrospective period, and the strengths of the instrument in supporting clients as they implement policy and institutional reforms and lay the groundwork for a sustainable recovery in the wake of the COVID-19 pandemic.** As the world rethinks development priorities in the wake of the pandemic, this report reviews the trends and performance of DPFs over the six-year Retrospective period and makes recommendations on how the tool could be enhanced to ensure it is relevant to address current development challenges. The Retrospective examines first how DPFs performed to support sustainable growth and poverty reduction in the context of selected global and regional crises in the past 14 years. The Retrospective then focuses on four selected areas which are core WBG corporate priorities: (i) fiscal and debt sustainability for macroeconomic stability and resilience, (ii) a conducive private sector environment to support private sector led development and job creation; (iii) gender equality, (iv) climate change adaptation and mitigation. The Report provides some insights on how DPFs have supported these areas in the past and how they are well positioned to support the GRID approach in the future.

5. **The DPF financing instrument continues to promote sustained policy dialogue and reform across diverse clients.** The Bank provided $81 billion in DPF financing over the Retrospective period, through 328 DPOs and 16 supplemental operations. Of these 147 were IBRD financed, and 181, IDA financed. Consisting of 26 percent in average in the Bank overall financing over the Retrospective period, DPF complemented and facilitated PforRs and IPFs in the Bank's lending instruments toolkit. Geographically, AFR dominated in terms of the number of DPOs (112 approved operations), whereas LCR absorbed the largest share of DPF commitments (25 percent of the total). The share of DPF in total IBRD commitments spiked to 39 percent in FY19, rising sharply from a 10-year low of 22 percent in FY18. This share continued to be high in FY20 and FY21, at 36 and 35 percent respectively, largely reflecting countries' response to the pandemic. The share of DPF in total IDA commitments increased significantly over the Retrospective period, reaching a peak of 24 percent in FY20, compared to an annual average of 12 percent from FY11-18.

6. **Bank policy on DPF remains fundamentally sound and its use has proven robust yet flexible over time and space in supporting countries' reform programs**. The range of DPFs, from supplemental, DDOs, CAT-DDOs, guaranteed-based, to stand-alone or programmatic, allowed Bank support to adapt to diverse circumstances and be fit for purpose. The use of DPFs introduced innovations (such as support to the fight against Gender Based Violence (GBV), to climate action, or to digital technology). It witnessed over the period a marked increase in multisectoral interventions, and greater focus on the real sector agenda. DPFs supported reforms related to agriculture, land use, energy efficiency and firm level competitiveness. DPFs also focused on disaster risk management, debt sustainability and private sector development, as elaborated in Chapter 3 in this Retrospective. Also, DPF complemented upstream IFC engagement and was instrumental in crowding in other public and private funding and in coordinating with development partners. Last but not least, DPFs and IMF programs were complementary, supporting sound macroeconomic framework and joining forces to support macroeconomic, and in particular, fiscal and debt reforms.

7. **In Fragile, Conflict and Violence (FCV) affected countries, DPF financing played a critical role in advancing policy and institutional reforms, despite policy reversals.** In FY20 and FY21, IDA DPF commitments in FCV countries reached highs of $1.8 and $2.4 billion respectively. The heterogeneity across FCSs (MICs, LICs) called for a nuanced approach to the use of DPF in FCS context, as reflected in the WBG FCV strategy. While Iraq, an IBRD FCV affected country, received large DPFs in FY16/17, DPFs in FCVs were provided mostly to IDA countries during the Retrospective period, with IDA's overall stronger focus on FCV translating into 25 percent of total IDA DPF commitments provided to FCV affected countries,

compared with 15 percent over FY10-15. FCV DPFs supported structural reforms related to Public Sector Management, including public finance management and public administration: over the period, 41 percent of prior actions (PAs) in FCVs DPFs focused on this theme compared to 23 percent in non-FCV. For example, DPFs in the Central African Republic supported nascent fiscal institutions and basic fiscal management and fiscal transparency to help rebuild public trust in an environment of frequent conflict.[2] Other areas supported by FCV DPFs were energy reforms (10 percent), notably in the series of DPFs in Cote d'Ivoire, Iraq, and Togo; and rural development (6 percent). FCV DPOs performed slightly less well than non-FCV DPOs, with about two third of DPOs receiving at least a moderately satisfactory outcome rating by IEG over the period (against 77 percent for non-FCV countries).[3] The Retrospective recognizes the challenge of policy reversals, acknowledging that the policy environment has been worsening in some FCV countries receiving DPFs during the FY16-21 period (Afghanistan, Sahel, Sudan).

8. **DPFs performed well during the Retrospective period, delivered results, and continued to contribute positively to development outcomes in client countries**. Almost 82 percent of DPFs evaluated by IEG that closed during the Retrospective period had an outcome rating of moderately satisfactory or above, as measured by the value of commitments, and 75 percent as measured by the number of operations. These outcomes were largely consistent with corporate targets (80 percent and 75 percent respectively), even though performance temporarily declined between FY16 and FY18. Operations in IBRD countries performed slighter better than those in IDA countries, perhaps reflecting the higher risks assessed in IDA countries. DPFs in AFR and LCR countries performed less well than those in other regions. Looking at results, over three-quarters of DPF expected results were at least partially achieved, with IBRD countries performed substantially better than IDA countries. DPFs are positively associated with enhanced policies and institutions (as measured by a countries' CPIA score), and when DPF performance is measured by the instrument's impact on CPIA ratings, DPFs continue to impact CPIA ratings positively.

9. **Good progress was made to help teams implement the provisions of DPF Bank Policy to ensure that social and environmental requirements in DPFs are adequately addressed[4], responding to the recommendations of the 2015 Retrospective**. Staff guidance on assessing environmental, natural resources and forestry impacts of DPFs has been revised and incorporated in training academies for Bank staff. The 2004 Good Practice Note has been updated to include more policy areas that are covered by DPFs, and an environment and social effects screening table has been incorporated in DPF program documents. The quality of poverty and social impact analyses (PSIA) has also improved**.** A 2016 Report on PSIAs[5] found that awareness and understanding of PSIAs has increased in the Bank, and the tool has become mainstream. PSIAs used a range of analytical tools that integrated poverty analysis with social impact analysis to answer relevant questions, such as the impact of subsidy removal on households, the distributional impact of tax reform, and firm level impacts of various business enabling reforms. PSIAs have also helped promote public awareness, transparency, and public debate, especially when teams prepared PSIAs early on in the DPF preparation process. Internal review processes have been

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2 Central African Republic, First and Second Consolidation and Social Inclusion DPF (P168035 and P168474)

3 "Satisfactory" refers to an IEG outcome rating of Moderately Satisfactory or above. Note that only 24 FCV DPFs were evaluated by IEG during this period.

4 Bank DPF Policy requires to assess whether prior actions in DPOs are likely to have significant poverty and distributional effects, especially on poor and vulnerable groups. Likewise, the Bank systematically analyzes whether specific country policies supported by an operation are likely to have positive or negative "significant effects" on the country's environment, forests and other natural resources.

5 Multi-Donor Trust Fund, PSIA Final Report, 2016. http://documents.worldbank.org/curated/en/701191479977368846/Poverty-and-social-impact-analysis-PSIA-multi-donor-trust-fund-final-report-2016

strengthened, with a dedicated group of specialists reviewing the team's assessment at corporate reviews of the DPF.

10. **DPFs have been particularly valuable to support crisis response, as indicated by their use and performance during global and regional crises.** The use of DPFs peaked during the Global Financial Crisis of 2009-10 (GFC), when the share of DPFs increased from an average of 32 percent of total commitments between FY01-08 to 39 percent in FY09 and FY10. DPFs also increased in response to the COVID-19 crisis, from 24 percent of total commitments in FY20 Q1-Q3 to 36 percent in FY20Q4. They accounted for 27 percent of total commitments in FY21, as investment projects accelerated sharply and also disbursed more quickly to support the health-related response to the crisis, such as purchase of health supplies and vaccines. The Retrospective analyzes the use of DPFs during 5 significant crises[6] and found that crisis DPFs focused on relevant reforms while ensuring close collaboration with the IMF and key development partners. The Bank used standalone DPFs more frequently than programmatic DPFs during crises, in contrast with non-crisis periods. The Bank expedited the preparation of crisis DPFs; preparation times where shortened but due diligence was maintained (especially during the pandemic). Beyond public sector management and public administration, crisis DPFs were designed to support reforms to address the unique circumstances of each crisis (e.g. health care for Ebola, social support for Food, financial sector for GFC, etc.) maintaining a level of focus on the medium-term reform agenda. FCV-affected countries received strong support, especially during the Ebola, Food, and Oil price crises which affected them significantly. DPFs responding to the COVID-19 crisis covered a diverse set of reforms, aligned with the pillars of the WBG Approach paper and building on policy dialogue and reform priorities in recipient countries.[7] The CAT-DDO instrument, which was developed to help provide clients with quick liquidity to manage natural disasters, proved particularly valuable to respond to the COVID-19 emergency, as indicated by the high number of disbursements from existing CAT-DDOs in 2020.

11. **Beyond crisis response, the Retrospective focuses on four areas anchored in WBG core corporate agreements:** (i) fiscal and debt sustainability for macroeconomic resilience, (ii) an enabling private sector environment, (iii) gender equality, (iv) climate change adaptation and mitigation. The specificities of FCS and Small State countries are highlighted throughout these areas. The Report finds that DPFs that supported these areas tackled relevant reforms and performed well on balance. There is room, however, to enhance the instrument to incorporate lessons learned and respond to shifting development priorities as developing countries recover from the unprecedented crisis induced by the pandemic.

12. **When countries need to increase fiscal space to invest in physical and human capital and build economic resilience, DPF support for policy reforms that strengthen fiscal and public debt sustainability have complemented global efforts to address debt vulnerabilities**. Over the review period, roughly one-

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6 Five regional and global crises between FY2008 and FY2021 covered 207 operations and included four historical crises: (i) the food price shock of 2007-08; (ii) the Global Financial Crisis of 2008-10; (iii) the Ebola virus outbreak in West Africa during 2014-16; and (iv) the oil-price shock of 2014-16. The fifth is the ongoing COVID-19 pandemic, for which the Bank has approved 101 crisis-response operations between Q4FY20 and Q4FY21 across all World Bank regions.

7 As per the World Bank Group COVID-19 Crisis Response Approach paper "Saving Lives, Scaling up Impact and Getting Back on Track", June, 2020, DPFs included actions across four pillars: Pillar 1 - saving lives, Pillar 2 - protecting the poor and vulnerable, Pillar 3 - supporting sustained business growth and job creation, and Pillar 4 - strengthening policies, institutions, and investments. http://documents1.worldbank.org/curated/en/136631594937150795/pdf/World-Bank-Group-COVID-19-Crisis-Response-Approach-Paper-Saving-Lives-Scaling-up-Impact-and-Getting-Back-on-Track.pdf

third of DPFs focused on fiscal and debt related reforms, with almost half of DPFs in FCV-affected countries focused on these areas. There was a steady increase in the focus on revenue mobilization measures including tax reforms and reduction of tax expenditures. A number of actions supported improved expenditure management. Expenditure-related reforms included better targeting of subsidies and reforms to improve expenditure efficiency in the areas of health, education, and social protection (often building on recommendations from Public Expenditure Reviews). About half the DPFs in countries at moderate or high risk of external debt distress focused on fiscal and debt reforms, and 90 percent of DPFs in countries with high risk of debt distress had at least one prior action focused on fiscal or debt sustainability. In FY21, DPFs complemented the recently introduced Sustainable Development Financing Policy (SDFP), and DPFs and the SDPF helped reinforce fiscal reforms in many IDA countries. Bank Debt and Fiscal DPFs performed better in countries with IMF programs, suggesting complementary effects between the two programs.

13. **By fostering an environment more conducive to private sector development, DPFs play an essential role in mobilizing private capital and supporting private sector led growth in client countries, especially critical in a context of tight fiscal space, as acknowledged by the World Bank Group's priority of Job and Economic Transformation (JET).** Business Enabling Environment (BEE) reforms facilitate private investment through overall improvements in the business climate, rather than mobilizing specific investment projects. Two-thirds of DPF operations during the Retrospective period included at least one policy action designed to improve the BEE, across 78 countries, with a total financing of US$39 billion. DPFs complemented a range of other WBG interventions, including IFC advisory services. Policy objectives most frequently targeted were: (i) expanding access to reliable, low-cost infrastructure through regulatory reform or private-sector participation (included in 57 percent of BEE-oriented operations); (ii) alleviating barriers to entry for new businesses and streamlining tax administration (52 percent); (iii) mitigating risks and uncertainty for private operators by strengthening the legal framework (50 percent); and (iv) deepening integration with the global economy through trade facilitation and logistics (41 percent). Most operations with BEE components were delivered through programmatic series, reflecting the medium-term nature of this agenda. BEE-oriented operations have performed as well as other DPFs, and have succeeded in bringing down business costs, improving trade facilitation, and facilitated private capital mobilization.

14. **DPFs have increasingly integrated gender aspects, closely aligning with the directions of the World Bank Group's Gender Strategy for 2016-23, from ownership and control of assets, more and better jobs, human endowments, to voice and agency**. The share of gender tagged DPFs have steadily increased from 24 percent in FY17 to 70 percent in FY21. All FY21 DPFs in the SAR region were gender tagged. Prior actions resulted in important results as varied as greater access to finance or access to property, increases in female jobs, preschool participation, strengthened child protection, access to education and health, internet or electricity, reduction in girl dropout, support to survivors of gender-based violence, or greater female representation in local elections. The in-depth policy dialogue embedded in the DPF process has proven critical to build awareness around gender issues and their developmental implications. A range of innovative DPFs – from the FY21 Guatemala Crisis Response and Recovery DPF that promoted financial inclusion for women to the FY20 Albania DPF that strengthened institutional frameworks for gender informed policymaking - included reforms that were supportive of gender balance and equality in diverse country settings.

63. **Rising climate change adaptation and mitigation challenges in client countries has led DPF to intensify support to climate change related-reforms.** In FY21, DPF climate co-benefits reached 26 percent and almost all DPFs (97 percent) received co-benefits, up from just 7 percent in FY15. Policy actions related

to adaptation actions include coastal management, updating of municipal land use plans, and forests and water conservation, and mitigation include greening the energy and transport sectors to reduce pollution. The CAT-DDO feature (and its extension to IDA countries in IDA18) has been especially beneficial in supporting climate resilience, given its focus on disaster risk management policies. The active portfolio of DPFs with CAT DDOs had an average climate co-benefit of 84 percent, largely attributable to policy measures supporting climate adaption. Successive DPFs with CAT DDOs for the Philippines helped build the country's disaster risk management system, while the first DPF with CAT DDO in an IDA country (Kenya, FY18) supported adaptation related reforms on land use and water resource management. On balance, climate-focused DPFs performed well. Though only 35% of climate DPFs have been rated by IEG thus far, all have received satisfactory or moderately satisfactory ratings. Climate-focused reforms supported by DPFs have led to results ranging from greater incentives towards reduced emissions, strengthened countries' climate change strategic frameworks, consistent government spending with climate change mitigation and adaptation, incentives for green financial investments, or, in sectors, increasing access to climate-resilient climate-smart technologies, increasing share of land use and forestry under sustainable practices or greater use of renewable energy, energy storage, and electrification of heat and transport, lower energy costs and greater energy efficiency.

Key Recommendations

15. **DPFs have continued to support relevant policy reforms while meeting clients' need for fast disbursing budget support.** In the context of a more adverse operating context in FY22 and beyond (higher extreme poverty, including in Middle Income Countries (MICs); higher debt; worsening fiscal positions across client countries) as well as increased WBG ambition reflected in the 2021 GRID framework and the preparedness agenda, there are some enhancements that can be made to improve the effectiveness of the instrument and strengthen its impact.

16. **First, the DPF with CAT-DDO instrument could be further enhanced to strengthen the Bank's support to crisis preparedness and response.** As the WBG explores ways to strengthen its financing products to support crisis preparedness and response, CAT DDOs can be enhanced to access additional sources of financing for rapid liquidity support while incentivizing further reforms for crisis preparedness and resilience and for climate adaption. Programmatic DPFs that include a CAT-DDO component were useful during the pandemic. The CAT-DDO proved to be especially valuable as a source of emergency support, and the expanded drawdown triggers helped countries access liquidity promptly. There are a number of ways in which CAT DDOs can be more relevant as a crisis preparedness and response instrument, especially in IDA countries. First, broadening the definition of the trigger to include different types of crisis (e.g. food) would provide countries with an enhanced contingency. Second, the instrument could more systematically include support for social protection systems related reforms in the set of reforms supported by DPF with CAT DDOs. The pandemic demonstrated the need to have well-functioning social protection systems in place for crisis response, with effective identification of beneficiaries and easy access arrangements via digital solutions if needed. These reforms can be considered in policy frameworks supported by CAT DDOs to strengthen crisis preparedness. A third area for enhancement is to strengthen the support to crisis preparedness through complementary investment programs and analytical and advisory services, between the approval of the CAT DDO and its eventual disbursement, which could happen much later than other DPFs, given the provision in the Policy for extensions of these operations. Finally, to mitigate the constraints posed by dedicating funds for contingency purposes and find a balance between providing a pre-approved credit line that yields immediate liquidity support while not tying up

scarce resources in a contingent instrument, the Contingency Emergency Response Components (CERCs) could be used more frequently with CAT-DDOs to leverage better any undisbursed balances across a country's portfolio through CERCs and other mechanisms. For IDA countries, a suite of enhanced instruments and financing sources could be considered, including more effective use of portfolio-level CERCs, a higher allocation for the Crisis Response Window (CRW), and improved incentives for CAT DDOs.

17. **Second, the targeting of fiscal & debt management reforms in DPFs to country with significant risk of debt distress could be sharpened.** After the COVID-19 crisis, many countries will need to rebuild fiscal space and continue addressing proactively the vulnerabilities inherited from the pandemic. Many countries continue to be challenged by insufficient domestic resource mobilization and significant debt risks as identified**.** The recently introduced SDFP complements and strengthens DPF support in IDA countries for debt management, fiscal sustainability, and debt transparency. There is merit in closely linking DPFs with PPAs prepared under the SDFP, in support of sound fiscal policy, debt transparency and debt management. In addition, the focus on fiscal and debt reforms could be increased in DPFs for countries at higher risk of debt distress. By contributing to macroeconomic resilience and creating the space for human and physical investment, these reforms actively pave the way for supporting efforts for a green, resilient and inclusive recovery, building on the GRID approach.

18. **Third, there is scope for better monitoring results and developing a methodology to capture impact on capital mobilization of DPF supported policies.** The private sector plays a key role for sustained growth and creating jobs which in turn are a core element of social inclusion. Greater attention could be paid to crafting reforms resulting in the creation of more quality jobs. While the MDB methodology on Private Capital Mobilization (PCM) focuses on direct transaction mobilization, DPFs play a large role on setting an environment enabling broader private capital investment. Better monitoring and measuring DPF support to policies ranging from supporting to the broader private investment environment, to public sector partnering with private sector through public procurement, Public-Private Partnerships (PPPs), divestment and privatization.

19. **Fourth**, **building on good progress over the past few years, there is space to mainstream more consistently across regions and countries gender equality in policy and institutional reforms supported by DPFs**. Attention to gender aspects across regions has been uneven. The need for a strong recovery further emphasizes the importance of economic empowerment of women. Education for girls, together with family planning, reproductive and sexual health, and economic opportunities for women will accelerate the green, resilient and inclusive dimensions of development.

20. **Finally, while by now almost all DPFs include some climate finance, intensifying efforts for impact requires to do more.** Because much of the climate agenda is related to policy and institutional change, client countries' climate-resilient and low emission development path may be effectively supported by DPFs. A more systematic focus on impactful policy and institutional measures in DPF can help to align climate relevant policies in client countries with the goals of the Paris Agreement. Continued focus on reforms in areas that support mitigation efforts - such as renewable energy, transport, and energy subsidy reform - as well as those focused on adaptation - such as climate smart agriculture and water conservation – would help generate additional avenues through which the instrument can support climate resilience and low-emissions development paths.