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# World Bank's Experience with Structural Reforms for Growth and Development

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### **Abstract**

The World Bank Group has come a long way in supporting structural reforms in its member countries. The most remarkable feature of its long 35 years and continuing journey has been its ability to listen, learn and adjust over time. It learnt relatively quickly that reform ownership is a necessary requirement for countries to support and sustain reforms. At the same time, it realized that reform implementation critically depends on credible institutions and good governance, which are frequently missing in its member countries, particularly the low-income ones. It also noted that over time the structure of reforms for promoting growth and development evolves, reflecting both changes in internal country conditions and a changing global environment. These important realizations are reflected in the evolution of the World Bank Group's policies and practice for supporting structural reforms, and help sustain a culture of learning from experience.

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# World Bank's Experience with Structural Reforms for Growth and Development<sup>1</sup>

Vinaya Swaroop

## I. Introduction

This paper reviews the World Bank's experience in supporting structural reforms in its borrowing member countries.<sup>2</sup> The World Bank Group (WBG)<sup>3</sup> has been involved in structural reforms for nearly 35 years and takes stock of its own performance on a regular basis – both through self-assessments of its operations as well as through independent evaluations. The WBG continues to take feedback from its supporters and critics in the development community through country dialogue, media reports and surveys. Learnings from its own experience as well as from the response and feedback it has received over the years, have been reflected in the improved design and development effectiveness of its structural adjustment programs. This paper narrates that development story.

This paper is organized as follows: Section II provides a definition and rationale for structural reforms. Section III traces the experience, learning and efforts to improve as the World Bank Group continues to support structural reforms of its member countries through advice, technical assistance and lending. Section IV highlights current challenges for structural reform and some areas of emphasis for World Bank Group support. Section V provides concluding remarks.

## II. Structural Reforms: A Definition and Rationale

In successful economies, the government and private sector work together to allocate resources in a manner that promotes equitable growth and job creation. The government provides an enabling environment of policies, institutions and public services that helps factor and product markets to work efficiently. This in turn allows private sector-led growth to take place.

In many cases, this process of resource allocation is (or gets) impaired. Countries face a host of problems: macroeconomic imbalances such as high inflation, growing fiscal deficit, rising debt and unsustainable current account balances; financial institutions unable to mobilize capital and allocate investments efficiently; barriers for competition (domestic and foreign); and weak institutions and governance that affect public service provision. In such situations growth suffers and income distribution worsens. The problems

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<sup>2</sup> World Bank's support to reforms in its client countries is often done in tandem with its sister organization, the International Monetary Fund (IMF), which has its own program of reform support. The programs of the two institutions in most cases are complementary; this paper, however, only discusses World Bank Group programs and the associated experience of such reforms.

<sup>3</sup> The World Bank Group comprises five institutions – the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA) and the International Center for Settlement of Investment Disputes. The term World Bank refers to IBRD and IDA. For convenience sake, this paper uses the term interchangeably; the term WBG is now more commonly used in the institution.

get exacerbated if countries experience shocks such as changes in commodity prices that affect their imports or exports, or reduced external financing.

Policy and institutional reforms are required to enhance market efficiency and improved conditions for growth and equity. Such reforms typically entail short-run costs – sometimes foreign exchange (or budgetary) needs and/or reduction in consumption for particular economic groups. The benefits of these reforms are in the medium and long run, usually in the form of higher growth and improved efficiency. Examples of such structural reforms include measures that (i) maintain low inflation and manageable fiscal and current account balances, (ii) promote competition and trade openness; (iii) improve a country's business environment by enforcing contracts and rule of law, enhancing the quality of public bureaucracy, and minimizing corruption; (iv) ensure the safety and soundness of financial institutions; (v) enhance labor productivity by providing infrastructure capital; and (vi) promote equality of opportunity to access public services.

### **III. Structural Reforms and the World Bank Group: An Evolution**

The World Bank has been assisting its member countries in undertaking structural reforms since the early 1980s. It has done so through a combination of dialogue with clients, analytical and advisory services, and policy-based lending. The latter has been the most effective instrument for supporting structural reforms in WB's borrowing members as it frequently combines country dialogue, technical assistance and analytical underpinnings of reforms (including lessons of experience) with financial assistance.

#### **III.A Supporting Reforms with Adjustment Lending: the Early Years – 1980s and 1990s**

World Bank's support to structural policy reforms started in earnest in the first half of 1980s. The program was known as "Adjustment Lending". It was initially created to assist developing countries to adjust their balance of payments that were negatively affected from the 1979 oil price shock. Usually undertaken in parallel with IMF programs, WB supported policies typically involved adjusting macroeconomic imbalances (related to budget and balance of payments) to promote growth. Later labeled as "first generation" reforms, the focus was on (a) stabilization that involved short-term fiscal and balance of payment adjustments, (b) addressing microeconomic distortions such as constraints to competition (domestic and foreign), and (c) incorrect prices of tradable goods.

In the 1980s, the WB committed over US\$27 billion in more than 190 adjustment lending operations in 64 countries in support of structural reform programs. During the 1990s, it increased to 346 operations for US\$72 billion in loan commitment in 98 countries. Such lending accounted for 17 percent in the 1980s and 29 percent in 1990s of total WB lending.

The list of countries included from the relatively rich—e.g., Argentina, Mexico, India, Indonesia, the Republic of Korea and Turkey, which were supported primarily from International Bank for Reconstruction and Development (IBRD) resources on nonconcessional terms—to the very poor. The latter group included Bangladesh, Bolivia, Central African Republic, and Zambia that got financial support from the International Development Association (IDA), the WBG's concessional arm of lending. The latter group included During the 1980s, Bangladesh and Turkey received the most adjustment support, while Mexico and Turkey were the two top borrowers in terms of financial resources. In the 1990s, Argentina and Cote d'Ivoire were the top two recipients in the former category, and Argentina and Republic of Korea topped the latter category.

Fast disbursing, untied financial resources were provided to support reforms for creating potential for higher growth. The areas covered were macroeconomic policy, trade policy, agricultural policy, industry, financial system and public enterprises. The initial focus was mostly on a stroke of the pen kind of short-term reforms (e.g., eliminating import quotas, relaxing interest rate ceilings, improving cost recovery for irrigation). Actual resource disbursement took place when countries met specific conditions that were linked to reforms. These conditions were deemed critical for achieving the intended outcome of the program.

Countries that approached the WB for support, typically faced a number of macroeconomic problems including low and/or declining growth, unsustainable current account deficits, high inflation and fiscal deficits, and rising debt. Lack of competition resulting from import substituting policies and distorted prices of tradables exacerbated the problems. Weak governance and poor economic management reflected low capacity, and with the advent of a shock (e.g., major changes in commodity prices, a poor monsoon, reduction in foreign financing) the picture would become bleak.

In supporting a program of structural adjustment reforms, which would include policies to address macroeconomic imbalances and improve efficiency of resource allocation, the WB would provide financial resources to ease the cost of transition and create conditions to restore growth. While each country embarking on its structural reform program had its own set of problems and required a customized solution, there were three broad categories in which reforms were concentrated: (i) reduction in public spending to match with available resources that were sustainable; (ii) removing trade restrictions and raising the domestic price of tradables relative to the price of nontradables to encourage exports; and (iii) promoting growth-oriented policies that involved strengthening institutional capacities and increasing savings and investment by removing financial repression (e.g., deliberate efforts to hold down interest rates). Lending for economy wide structural reforms – known as Structural Adjustment Loans (SALS) – was frequently supplemented by lending in support of sector-specific reforms (e.g., financial sector and energy sector). The latter were called Sector Adjustment Loans (SECALs). Towards the end of 1990s, the WB started supporting structural reform programs at the regional or state level in large federal countries.

In the early 1990s, the WB also supported structural reforms in socialist countries that were in transition. Adjustment support, focused generally on enterprise and financial restructuring, was provided to Algeria, Hungary and Poland. Improvement in outcomes were more problematic in the socialist countries as they had greater price distortions and institutional weaknesses. Most socialist countries, especially the middle-income ones, were well endowed with human capital which was as good as in Latin American and East Asian countries. Yet, the human capital endowment, while good for economic recovery, was not enough to counter the worse structural and institutional deficiencies.

#### *Adjustment Lending supported reforms: what worked and what did not?*

The WB's own assessment of the reforms supported by its adjustment lending is mixed, especially in the 1980s. While the reforms to correct macroeconomic imbalances and price distortions were necessary to create stability, promoting growth and enhancing overall development required many more and different types of structural reforms. There were several external studies and evaluations that reflected on the WB's mixed performance in a more critical way. In cases when the country's economic performance did not improve or the progress was uneven, the debate often centered on whether the country failed to properly implement the reform and adjust or whether it was due to the faulty design and process of adjustment.

One key finding of the WB's own assessment was that its involvement in a country's structural reform program supported by adjustment lending was, on average, associated with better growth performance. The

WB also noted that a stable macroeconomic framework was a prerequisite for structural reforms to succeed. Yet another important finding was that implementing reform and growth recovery took much more time than was initially anticipated. While for most countries the adjustment process took years with significant costs in transition to growth recovery, there were a few exceptions. For example, in the cases of Indonesia, the Republic of Korea and Thailand – all of which had fewer macro problems and micro distortions to begin with – the adjustment process following the 1997 East Asian crisis involved a swift transition to a new growth path. For other middle-income countries (e.g., Chile, Mexico and Morocco), the recovery took longer. In Chile and Mexico, there was lack of transparency in the privatization programs; financial deregulation and speculative bubbles created more problems, which made the recovery longer. The process of adjustment was more difficult for low-income countries, who faced many more structural problems to begin with. The low-income countries (the sub-Saharan African economies were dominant in that group) had low human and physical capital, weak institutions and markets, lots of price distortions, unsustainable macroeconomic imbalances and debt. For many low-income countries adjustment helped secure a recovery but did not solve their long-run development problems including sustaining growth. The evidence suggested that for low-income countries, adjustment and good macroeconomic management was necessary for stability and restoring growth, but not sufficient for transition to a sustainable growth path.

External research also noted that adjustment lending produced mixed outcomes. In reflecting on the effect of IMF and World Bank adjustment lending on growth, Easterly (2003) noted that in thirty-six countries which received ten or more adjustment related loans from the IMF and World Bank during 1980-1998, the median growth rate of income per person over the same period was zero. He also noted that his results relate to the impact of “structural adjustment lending” and not “structural adjustment policies” which he argued matter for growth. There is plenty of evidence (Burnside and Dollar [1998], Easterly and Levine [2001]) that countries with better policies including good macroeconomic management and institutions, grow faster. Examining the impact of adjust programs in Pakistan, McGillivray (2003) noted that the adjustment program supported by the World Bank and IMF has not stimulated growth in the country. In their research in measuring the impact of WB adjustment lending on per capita GDP growth, Butkiewicz and Yanikkaya (2005) found that such lending stimulates growth in some instances, particularly in low income countries and poor democracies. The mixed performance of adjustment lending was attributed to poor program design and ill-chosen policies (Rodrik, 2008). More recently, surveying the literature on the impact of WB adjustment lending on macro variables, Smets and Knack (2014) have noted that having too many policy conditionalities in WB loans were perhaps not too constructive in improving the economic policies of the loan receiving countries.

In several of its documents that reviewed the performance of reforms supported by adjustment lending, the WB reported some of the shortcomings of its early approach: first, there was evidence that while the poor benefit from adjustment policies in the medium and long term, some of them did suffer due to recessions that resulted during transition. Second, the adjustment process led to a decline in overall investment – both public and private. In some cases a decline in public investment was anticipated as often it was misdirected and/or unsustainable. The recovery in private investment usually took longer as it was linked with the credibility and sustainability of reforms. In this context, the time lag was smallest in East Asian economies which reformed successfully; it was longest for low-income countries. Third, general cuts in public spending did not carefully look at the composition of spending and often came at the expense of critical operations and maintenance spending. In many cases, spending allocations within the social sectors were a

problem, with inadequate spending on complementary inputs—such as medicine and textbooks—relative to labor.

There were several criticisms by the development community (countries, NGOs and academics) of the World Bank’s approach to support structural reforms through adjustment lending.

Main criticisms were:

1. Reforms were forced upon countries and there was little country ownership of the program;
2. Reforms did not have a human face as the poor suffered from reduction in public spending;
3. Emphasis on getting relative prices right paid little attention to weak institutional capacity; and
4. By providing financial assistance, the WB was “buying” reforms because if the reforms were good for a country, there was no need for money.

These were serious charges for a leading development institution that prides itself in promoting sustainable growth and reducing poverty across the world. The WB had to engage in reflection on these issues and it did so.

External criticisms as well as its own internal assessments, influenced the design of subsequent programs. For example, the WB realized that its program of quick-disbursing lending was more effective in addressing balance of payments problems and policy distortions that can be quickly removed (e.g., import quotas, price subsidies). However, many reforms (e.g., financial sector restructuring, public enterprise restructuring and privatization) were complex and involved time-consuming organizational changes usually through a long drawn-out sequencing process.

Noting that reforms were taking longer than anticipated in most countries, the WB decided that a more flexible approach to support was needed. Timing and sequencing of reforms is fundamental. The condition of the policy regime to be reformed also matters—some are more “ripe” for reform than others. Sequencing of reform steps is context-specific—sometimes smaller steps need to precede larger ones, and vice versa. The new approach aimed to (i) spread the reform support over the medium term to reflect the complex nature of institutional reforms, and (ii) have a mix of balance of payments support and more traditional project financing.

The experience of the 1980s and 1990s also showed that the WB’s support of structural reforms was more successful when the reforms were part of a program that was designed by the government and where the political economy challenges to reforms were successfully addressed. Potential losers from reform are more likely to mobilize than winners. Major reforms should be accompanied by coordinated efforts to persuade voters and stakeholders of the need for reform and, in particular, to communicate the costs of non-reform. The WB’s research showed that reforms could be effectively implemented and sustained when the country’s commitment was strong. Responding to country ownership criticism, the WB realized that any effort to impose a reform program on a country was likely to fail and was subject to policy reversals.

It was understood that no matter how well-designed a structural reform program was with all the associated benefits to the majority of the country’s population in the medium to long term, there were some interim costs associated with reforms such as reduction in government spending, subsidy removal and restructuring or privatizing inefficient public enterprises. Indeed some of the poor did suffer while the structure of economy was adjusting. Moreover, there was a recognition that the poor often did not benefit from reform supported economic expansion in the formal sectors of the economy. Their exposure was generally restricted to the informal sector for economic opportunities and they had limited access to better health care



and education to build their human capital. It was determined that it was important to undertake detailed analyses of the social impact of reforms, make markets work for the poor and introduce targeted measures to alleviate the short-run costs of adjustment to those who were losing (e.g., job losers in the restructuring of public enterprises, the poor facing higher prices of commodities and services due to subsidy reduction). Beginning in the 1990s, WB supported adjustment programs started to include measures to protect the poor and vulnerable through targeted interventions in social expenditures and safety nets.

On “buying” reforms, the WB’s position has been that good policies and institutions are necessary for a country to grow and develop faster. Growth and development, however, require investment from domestic and foreign sources. The latter also brings new and improved technology as well as management skills. Investment, particularly foreign, requires credibility of reforms and leads to eventual recognition though with a time lag. Fast disbursing financial support from the WB provides foreign savings to the reforming country which may otherwise take time to come from other foreign sources. Indeed WB’s support was often a catalyst or precondition for other lenders to adopt a more supportive stance vis-a-vis reforming countries.

### **III.B Learning from Criticism and Changing Times: 2000s and the More Recent Years**

Over time, the focus of adjustment lending moved away from the narrow agenda of short-term stabilization and correcting distortions to encompass social and institutional issues that were necessary for long-run growth, equity and development. During the 1980s and 1990s, many countries were able to make corrections in relative prices, lower trade barriers (tariff and non-tariff) and liberalize their economies. Major macro imbalances including high inflation, rising fiscal and current account deficits were addressed. Thus, with a reduction in economic distortions and macro stabilization achieved in many countries, the WB’s major focus became improving public sector governance and accountability through institutional reforms. With more experience and learning from doing, listening to critics, and making corrections, the quality of the WB’s support to structural reforms of its client countries improved steadily throughout the 1990s. In 1999, a new programmatic approach was adopted by the WB to support reforms that involved multiyear policy changes and institution building in low- and middle-income countries. The challenge for the 2000s and beyond was to support a subset of policy and institutions reforms that were part of the country’s well laid out structural reform agenda that had a medium-term dimension.

In 2004, the World Bank’s shareholders requested a review of the WB’s policy and practice of conditionalities in supporting reform programs of its borrowing member countries. Following that review, which commissioned several background papers, a new World Bank operational policy<sup>4</sup> came into effect. It governed all fast-disbursing lending supporting policy and institutional reforms. The new policy reflected the lessons of experience and findings of internal and external evaluations. Gone were the general reform prescriptions on specific policy areas (e.g., privatization, financial sector reform), which often failed if they were not tailored for the country specific situation.

The overarching objective of this untied assistance<sup>5</sup> – now called Development Policy lending – was to support policies and institutions in a country to achieve sustainable growth and efficient resource allocation. The key features of the new policy were: (a) emphasis on government ownership of the reform program; (b) flexibility in the program supported; and (iii) limited prior actions as opposed to a long list of conditions in multi-tranche operations. In order to increase the success of reforms, the WB started making an

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<sup>4</sup> From Adjustment Lending to Development Policy Lending: Update of World Bank Policy, June 2004.

<sup>5</sup> With the exception of items on a standard negative list.

assessment of the overall country environment within which reforms could be successfully and sustainably implemented. Such assessment included country's fiduciary arrangements, impact on environment, and the likely impact of reforms on policy and social conditions.

### *Changing focus and design of reforms*

Learning from experience and with evolving client needs, the focus of reform changed. The WB moved away from short-term macro adjustments and removal of micro distortions to a strong emphasis on public sector governance including public expenditure and fiduciary reforms, which became a special focus in low-income countries. Economic management reforms declined in importance reflecting relatively better management of the economy (in the absence of shocks).<sup>6</sup> Reduction in trade barriers across countries – that were supported by the WB – has led to a decline in conventional trade reforms involving liberalization and tariff rates. Most of the remaining trade related reforms now focus on improving institutions such as customs agencies and other regulatory barriers to trade and competition. Private sector development and financial sector reforms continued to be important in the 2000s. There was a change in emphasis though: privatizing public enterprises gave way to a focus on creating an inviting environment for business investment, domestic and foreign.<sup>7</sup>

A new emphasis was added on good governance as new research findings showed that ineffective public institutions and weak governance were major constraints to sustainable growth and development. Public sector reforms that included improving public service delivery and accountability, redefining procedures in budget management, strengthening courts and oversight agencies (e.g., auditor and accountant generals), building anticorruption institutions, became an important component of WB supported structural reforms in its member countries. In more recent years (2012-2015), while reforms in the area of public sector governance and rule of law are still dominant, the focus on social development and protection has increased.

After years of sustained reform efforts and stable macroeconomic policies, the relatively richer group of the WB's IBRD countries had achieved moderate to high economic growth in the second half of 2000s (just before the global economic crisis hit in late 2008). Given their success in attracting capital flows and expanding exports, several middle-income countries started tackling "second-generation" structural reforms with measures to improve competitiveness and raise labor productivity to enhance growth. Countries also started to mitigate the adverse impact of rapid growth on the environment. Many of these countries were in the Latin America region and sought support from the WB.

While the WB support to low-income countries' reform program continues to be multi-sectoral, the richer and more advanced IBRD countries started requesting support for sector-specific reform programs. In many cases they sought WB's assistance in sectors such as housing, energy, and climate change, only in the implementation of a well-articulated government program. For example, the WB supported housing and climate reforms, as well as measures to improve competitiveness in Mexico. Reforms addressing environmental management and green growth were supported in Indonesia. In Brazil, the WB has supported public administration, housing and social security reforms through its policy-based lending instrument. In Chile, a high-income country, the WB supported reforms related to public works. In Bulgaria, the WB

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<sup>6</sup> However, with the advent of the global economic crisis, demand for support in this area started increasing in 2008 onwards as the recessionary effects of the crisis started affecting countries. See Box 3.

<sup>7</sup> Since its inception in 2003, the WB's annual flagship report of Doing Business started providing annual quantitative data on the main regulatory constraints affecting domestic small and medium-size enterprises. This has led to a healthy competition among countries to improve their business environment. For example, the Indian government declared in early 2015 that its aim is to improve its business environment and be in top 50 nations in World Bank Group's ease of doing business ranking.

supported structural reforms pertaining to improving labor market flexibility and social services. Several IBRD countries also sought support to stand-alone financial sector reforms.

Since most of these countries had relatively easy access to capital markets – at least until the global economic crisis started having its negative effects worldwide – the demand for support in sector-specific structural reforms reflected technical expertise and the quality of analytical work that the WB puts together for the borrowing country. At a client’s request, WB staff provided assistance through their analytical work, bringing lessons of experience and solutions from other parts of the world. In Poland, for example, the WB supported reform program focused on areas of strategic relevance for the country’s priorities. The client sought help from the WB as it had an established track record of strong technical capacity and cross-country experience. Moreover, instead of covering an array of measures, the program simply focused on one issue: public finance.

### *Responding to the Global Economic Crisis: 2008 – 2010*

In response to the global financial crisis and the resulting worldwide recession, the WB stepped up its financial support, particularly in 2009 and 2010. Development policy lending supported reforms in countries with diverse needs from upper middle-income countries such as Croatia to fragile states such as Liberia. A key objective of the financial support (particularly in IBRD countries such as Bulgaria, Indonesia, Mexico, Poland, Turkey and Tunisia) was to help countries cope with tightening credit markets and provide funds to protect and sustain government spending on infrastructure, health, education and social protection. The latter was vital to protect the poor and vulnerable from the worsening economic situation.

Policy reforms were mainly in the areas of financial sector, fiscal management, safety net programs and access to trade finance. The area of social development and social protection received substantially increased attention. Support for reforms in these areas were designed to increase resilience to the worsening impact of the global crisis. For example, financial support to Tunisia was provided to address the declining export demand due to the global recession. The project supported reforms to lower trade transaction costs and to accelerate integration with the European Union. Similarly, an operation in Indonesia supported policy and institutional actions (including strengthening the institutional framework for handling possible bank failures) to prevent a possible domestic crisis.

Several sector specific operations were designed to strengthen social protection and mitigate the impact of the crisis (e.g., Albania, Colombia, and Latvia). Due to difficulties in operating in a fast moving economic crisis, many of the WB’s operations did not focus on complex medium term structural reforms. The need of the hour was to stabilize economies and provide signals of support to domestic and international markets. The good thing was that many countries were in good fiscal condition with strong policy frameworks and sound financial systems when they entered the crisis.

A crisis response window was created as part of WB’s response to the global economic crisis, with US\$1.4 billion resources, to provide additional resources to low-income IDA countries. The objective was to protect core spending on health, education, safety nets, infrastructure and agriculture and build resilience to cope with the challenging situation.

Constraints to growth and fiscal sustainability have been present (and growing in some cases) at the sub-national level in large federal countries. The WB has used development policy financing at the sub-national level in Argentina, Brazil, India, Mexico, Nigeria and Pakistan in support of fiscal policy and structural reforms. The WB had the opportunity to support policy and institutional reforms in those areas in which

responsibility was devolved to the decentralized level. WB involvement in such cases offers an independent “third-party” support for state-level reform and provides a financial incentive for maintaining subnational fiscal discipline.

*Design issues.* Reflecting on the important lessons of reform ownership, the WB started emphasizing implementation of a country's own program of policy and institutional actions. In choosing which countries and which structural reforms to support, the WB started looking for a good policy and institutional environment<sup>8</sup> with above-average policy performance and a track record of progress. While supporting reforms with loans or grants in countries with poor records was not necessarily ruled out, the new approach was to carefully assess and balance risks and rewards. It was felt that in countries with major fiduciary challenges, analytical and advisory services, instead of untied financial resources, were better suited to support reforms.

Another key element in design change was the introduction of a medium-term perspective in the reform program. A series of self-standing lending operations were processed as part of a programmatic approach to support and implement what essentially became a country's medium-term structural reform program. Each of the self-standing lending operation required prior actions on a set of policy and institutional reforms; future expected reform actions were laid out for subsequent reform operations.

As the focus of support shifted from short-run to long-run structural reforms that required major institutional changes, the specific lending conditionality against which resource disbursement was linked, became more complex. The WB soon realized that more complex and detailed conditions that were designed to address performance deficiency and capacity limitation were becoming counterproductive. Moreover, there were concerns about overloading the government's reform agenda with too many intrusive conditions. As a result, the WB started streamlining conditions (often in collaboration with the IMF's program) with initiatives to enhance country ownership of the reform program. The number of conditionalities – against which resource disbursement is linked – have declined from an average of over 30 per country program in the late 1980s to about 12 in mid 2000s to the current average of 8.

The rationale for this reduction in policy conditions was further supported by a WB research paper which investigated the impact of WB development policy lending on the quality of economic policies in the recipient countries. The study found that the quality of policy increases with a diminishing rate as the number of policy conditions increase. (Smets and Knack, 2014). In a subsequent study, Smets and Knack (2015) also examined the impact of lending conditionalities associated with public sector governance on the quality of public sector management and institutions. The results were similar: the conditions when limited had a positive impact on improving the quality, but as the number of conditionalities increased the relationship reflected an inverse U-shaped effect.

A 2005 consultation with client countries suggests that the earlier charges and criticisms of reform “imposition” seem to have faded, especially in view of the new medium-term and partnership approach of policy-based lending. Nowadays, the country designs its development strategy and implements its own structural program. Working with the government, the WB selects a few important elements of policy and institutional actions that are part of the country's reform program for Bank's involvement. It provides financial assistance in support of implementing the selected policy and institutional actions, mostly in a

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<sup>8</sup> The World Bank uses its Country Policy and Institutional Assessment (CPIA) ratings – a summary rating of a country's policy and institutional environment that affects IDA allocations – to make such assessments.

medium-term development context.<sup>9</sup> As a share of its lending, more support is provided to IBRD countries than to IDA countries, partly reflecting fiduciary problems in low-income countries. Reforms related to public sector governance and rule of law – including public financial management and procurement, and regulatory environment – continue to dominate WB’s choice of reforms to support.

#### **IV. Current Challenges and Areas of Emphasis**

Global deflationary tendencies, weak commodity prices and capital flows, skittish financial markets, and subdued global trade are amplifying weaknesses in many emerging market and developing economies, including low productivity growth and stubbornly high structural unemployment. With limited flexibility in fiscal and other demand management policies and tightening capital markets, structural reforms have come to the fore as necessary to address macro-financial imbalances and risks, and to underpin productivity improvements and faster growth.

The World Bank Group continues to vigorously support structural reforms in its member countries to promote equitable growth and reduce poverty. In this effort, it is now guided by the Twin Goals of ending extreme poverty by 2030 and promoting shared prosperity globally, which were adopted in a new WBG Strategy in April 2014 with the strong endorsement of the development community. The WBG has made a commitment to support countries to achieve these goals in a sustainable manner.

In many advanced middle-income countries there is a realization that the structure of reforms that were key at the lower income levels will not be sufficient to move them up the income level. “Second-generation” reforms – involving innovation and knowledge economy, among other things – are being tried. Countries like Kazakhstan, Peru and Romania want to take the next step and join the ranks of high-income countries. When approached, the WBG continues to use Development Policy lending as an instrument to support these countries in their advanced reform agenda.

Some of the current areas of emphasis for structural reform support are highlighted below:

***Promoting good governance and public sector reforms.*** Improvements in government performance continues to be the center piece of WBG’s engagement in supporting structural reforms in its member countries. More specifically, the supported reforms relate to measures that improve (i) public financial management and procurement, (ii) governance and accountability, and (iii) public service delivery. The WBG has learnt too often that in the absence of well-functioning institutions, financial resources fail to deliver development results. In resource rich countries, following and adhering to the Extractive Industries Transparency Initiative (EITI) principles<sup>10</sup> has become an important component of good governance. Recent research (Smets and Knack, 2015) shows that loan conditions related to public financial management and tax reforms are more effective than those related to anticorruption or civil service and administration reform. The latter, it is argued, requires changing the behavior of a larger set of “deconcentrated” actors, which in most circumstances is a tough ask.

***Increasing domestic resource mobilization.*** Domestic revenues already provide most of the resources available for developing countries to meet development objectives—more than aid and other forms of

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<sup>9</sup> Since the new policy became effective in 2004, the WB has provided US\$117 billion worth of support in over 650 development policy operations to its borrowing members. For the five-year period between 2000 and 2004, there were 325 policy-based lending operations worth US\$33 billion.

<sup>10</sup> The EITI principles promote high standards of transparency and accountability when EITI member countries report revenues paid and/or received from selling the country’s natural resource wealth.

financing. However, average tax levels in developing countries are half that in developed countries, significantly limiting the public resources available to direct the development process. The way in which fiscal revenues are collected is also important as it has an impact on growth and development, and can be instrumental in promoting inclusive growth. The WBG is committed to assisting developing countries in collecting domestic fiscal revenues in a sustainable and equitable manner that supports high-quality inclusive growth. Resources collected by governments need to be spent better and in line with countries' development objectives.

**Supporting inclusive growth.** Growth by itself is not enough for sustained and well-rounded development. Patterns of growth and trends in income inequality are important if all segments of society are to benefit from growth. In countries afflicted by slow growth and pervasive poverty, poverty declines when growth patterns become more labor intensive and when people's work becomes more productive. More equal income distribution appears to be correlated with longer growth spells, and greater equality of opportunity with economic dynamism. In its programs, the WBG is paying increased attention to poverty and social impact analysis to better understand and enhance the transmission channels of reforms that are likely to have significant positive distributional effects. For example, structural reforms involving increases in taxes or energy tariffs, while necessary for ensuring sustainable growth, frequently affect poor and vulnerable households in the short run. The challenge faced by the WBG is to assist the client country in assessing the nature and incidence of these impacts and identify ways to mitigate them among affected groups.

In recent years, countries in the Latin America region have done well in promoting equitable growth and reducing income inequality. For example, between 2001 and 2013, nearly 25 million Brazilians escaped poverty and the country experienced a rapid decline in inequality, with the Gini coefficient (of household incomes) falling from 0.59 to 0.53. These reductions in poverty and inequality was largely due to successful policies of social inclusion in the face of a booming economy which was fueled by favorable external conditions. The road to prosperity for the majority of poorer Brazilians has been through a formal sector job. For the poorest Brazilians, however, social transfers have been more important than labor markets. Over sixty percent of the decline in extreme poverty in Brazil between 2001 and 2013 was due to changes in non-labor income, mainly transfers from the *Bolsa Familia*, the conditional cash transfer program. These are important lessons for other countries to follow.

**Gender equality as smart economics.** The WBG has been advancing women's economic empowerment in its member countries to promote inclusive or shared growth. Research has shown that lack of women's economic empowerment restricts the full growth potential of a country. It also leads to less favorable education and health outcomes for children. A recent World Bank Group report<sup>11</sup> focused on four priority areas for policy: (i) reducing excess female mortality and closing education gaps where they remain, (ii) improving access to economic opportunities for women, (iii) increasing women's voice and agency in the household and in society, and (iv) limiting the reproduction of gender inequality across generations. In recent years, the WBG has supported gender-related reforms through its development support lending. For example, in Vietnam, a reform related to female participation in civic engagement was supported. In some African countries, reforms related to education policy for girls have been supported. The topic remains challenging, but trends in gender-informed lending instruments continue to move upwards.

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<sup>11</sup> World Development Report 2012: Gender Equality and Development.

***Social protection.*** Following the global economic crisis, the area of social protection has been deeply emphasized in WBG's supported structural reform programs. The reforms have focused on strengthening social safety nets, social inclusion, and targeting resources to the most vulnerable groups. Innovative social assistance programs have been designed using new targeting methods (like proxy means-testing) and conditional cash transfers. For example, in Pakistan the WBG assisted the government in strengthening and expanding conditional cash transfer program for primary education. Reforms in the social protection system have been supported in Colombia through successive recent programs. The reform agenda there has moved from the basic establishment of safety nets to issues related to coverage, integration of schemes, and reduction of high administrative costs and inequity. In Panama, the WBG supported the increase in monetary transfers to the beneficiaries of the conditional cash transfers program to help extremely poor households to cope with increase in food prices and the impact of global slowdown.

***Environmentally sustainable growth.*** The global climate crisis is challenging countries that seek sustainable high growth paths. Climate variability and natural resource scarcity are frequently exposing developing countries to increased input costs, as well as energy and water shortages. As significant carbon emitters, industries and their supply chains are facing added pressure to mitigate their environmental impact. Global action and national level policies can provide incentives for energy saving and resource efficiency through clean technologies and other innovation. The WBG has been increasingly supporting policy and institutional reforms aimed at enhancing environmental sustainability. In recent years several policy-based lending programs have been designed with a primary focus on improved natural resource and environmental management and green growth. For example, building on existing government priorities, a recent development policy project in Morocco supported government's ability to meet its green growth commitments. Similarly, a series of operations were designed by the WBG to support a subset of the Government of Himachal Pradesh's (a state in India) plan in making a paradigm shift towards an environmentally sustainable model of economic growth.

***Enhancing competition for productivity and job growth.*** Open trade regimes, competitive markets, and favorable investment climates are key to economy-wide efforts to spur growth, productivity, and job creation. Public infrastructure and national innovation capacities are also vital. The broad range of issues implied by these requirements make integrated solution approaches necessary. Examples of WBG integrated solutions to advance these conditions include a series of policy-based lending operations in Georgia, combined with analytical and advisory services, which aim at accelerating private sector competitiveness. Key elements include support for greater private sector involvement in economic policymaking, stronger competition policies, and greater access of SMEs to public procurement. The series includes support for reforms around financial deepening, financial sector transparency, and expanded access to collateralized finance, as well as measures aimed at building a dynamic innovation ecosystem, promoting ICT development, and lowering transactions costs to exporting firms. Another example is the series of policy-based operations for Indonesia that support economic integration through connectivity across different islands of the country and connectivity to global markets. The operations strengthened various economic corridors while boosting cost competitiveness of businesses, and attractiveness to investment. Other measures included establishing regulatory and institutional frameworks to drive the connectivity agenda, strengthening intra-island connectivity between growth poles through the island transport network, improving ICT connectivity through greater competition in broadband services and domestic shipping, and enhancing trade facilitation.

## V. Conclusion

The World Bank Group has come a long way in supporting structural reforms in its member countries. The most remarkable feature of its long 35 years and continuing journey has been its ability to listen, learn and adjust over time. It learnt relatively quickly that reform ownership is a necessary requirement for countries to support and sustain reforms. At the same time, it realized that reform implementation critically depends on credible institutions and good governance, which are frequently missing in its member countries, particularly the low-income ones. It also noted that over time the structure of reforms for promoting growth and development evolves.

These important realizations are reflected in the reform programs that the WBG now supports. It ensures reform ownership by supporting a segment of a country's own structural reform program reflected in some kind of a development strategy document (for example, a medium-term plan or an economic vision document). Building institutions and capacity to implement reforms is a tough, time-consuming challenge. But the WBG realizes that in the absence of reasonably well-functioning institutions manned by people with requisite training and competence, reforms can be written on paper, but their effective implementation may continue to be elusive. In advanced IBRD countries, the WBG often leverages its sector/issue specific analytical work and technical capacity to support reforms; financing is not the most important reason for assistance.

In some of its new challenges, the WBG is working with its member countries to promote growth that is inclusive for all groups and income classes and is environmentally sustainable. In countries that have become middle income and have relatively easier access to capital markets, the challenge for the WBG is to showcase its global knowledge and expertise in supporting reforms. With proven ability to attract foreign capital flows and increase exports, many middle-income countries are in the midst of tackling "second-generation" structural reforms with measures to improve competitiveness, promote innovation and raise labor productivity to enhance growth. Environmentally sustainable growth is also occupying a lot of their attention. The good news is that such middle-income countries, including several members of the Emerging Market G20 countries, continue to show trust in the WBG's abilities in seeking assistance to support structural reforms in key sectoral areas, especially during times of non-crisis. This results in the WBG continuing to learn, gain more experience and improve upon the solutions it can provide.



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