PBL: an efficient instrument for supporting developing countries at an advanced stage

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Over the last 15 years, a number of low-income countries (LICs) have developed into middle-income countries (MICs), and this trend is rising. MICs continue to be considered as developing countries, as they still have sizeable deficits with regard to sustainable and socially balanced development, despite the increase in per capita income. In fact, middle-income countries and not low-income countries have the largest number of people living in poverty at the moment. MICs typically have sustained deficits in the areas of infrastructure (particularly transport, energy and residential construction), environmental and climate protection, as well as social protection and working standards.

Stronger local structures and more financing options

Due to an increase in economic momentum, strengthened institutional capacity and higher tax revenues, there is a growing number of options open for developing countries at an advanced stage to cover their enormous development financing needs. MICs are not only increasingly able to draw on their own growing resources (domestic resource mobilisation – DRM), but they are also receiving greater access to international capital markets. Nevertheless, their limited credit ratings mean that they are still only able to trade in relatively low volumes and often with very unfavourable conditions. International development cooperation partner organisations no longer provide grants to these countries, but are offering them soft loans instead.

Stronger partners allow for new modes of delivery

The growing ability of these countries to drive their development autonomously is also facilitating the use of advanced cooperation instruments ("modes of delivery") within international development cooperation. In addition to the traditional project-related form of financing, which involves development partners keeping a close eye on every step of the project, there are now also forms of financing in which the measures are implemented very independently by the partner country. In these forms, the relationship between development partners and national counterparts is shifting from a technical implementation level to the sector policy level.
In terms of development policy, this form of cooperation is extremely desirable, as it encourages and demands that the partners take self-responsibility (*ownership & commitment*) and strengthens local structures (*alignment*). As the execution of the individual measures is no longer closely followed on an international level, there is a reduction in overall costs and resources are utilised in a considerably more efficient manner.

"Policy-based lending": sectoral reform and more favourable financing in one package

The policy-based lending (PBL) instrument combines the concepts of sectoral dialogue, programme approach, self-responsibility and effective funding.
PBLs particularly allow for the implementation of large-scale national reform initiatives (e.g. energy turnaround, environmental protection programmes, decentralisation processes and sustainability strategies). In these initiatives, the focus is placed on working together under the auspices of the partner government to draw up reform measures. Once the reform programme is drawn up, the provision of large-volume, low-interest loans will also ensure that the financial basis is created for the programme to be implemented quickly and on a large scale across local structures. The loans are normally used to finance the investment measures needed to implement the reform programme. The funds are included in the partner country's budget as part of the national fiscal plan. In contrast to general budget support, the PBL instrument is aimed at developing countries at an advanced stage with relatively high-performing institutions, a well-established public finance sector and a strong commitment to reform. Financing is not offered in the form of grants, but rather by means of soft loans and only once reform measures have been set out. The sector policy conditions are thus already met ex ante and the implementation of the reforms is monitored intensively.

Such a combination of ambitious sectoral reform and favourable financing is often better suited to the need for assistance and increasing self-confidence exhibited by developing countries at an advanced stage than traditional project financing. Furthermore, this combination can also provide a crucial impetus in some countries for the necessary reforms to be tackled promptly and tangibly. The instrument also appeals to development partners, as the loan structure normally allows development banks to provide such financing via their capital market access without putting too much strain on budget funds.

Growing significance for development cooperation

PBLs are now a fixed component of the funding instruments of development banks. The World Bank, for example, executes around one third of its commitments using PBL instruments, which equates to approx. USD 9.8 billion in 2015. Independent evaluations have also confirmed that the instrument is very efficient. In light of the growing number of middle-income countries, PBL are likely to become even more important in the future – particularly for the implementation of international commitments in the areas of climate and sustainability.■