RE-409

APPROACH PAPER: EVALUATION OF THE FUND FOR SPECIAL OPERATIONS DURING THE EIGHTH REPLENISHMENT (1994-2010) – PART II

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ABBREVIATIONS

CIPE	Country Institutional and Policy Performance Evaluation
DSF	Debt Sustainability Framework
EPBA	Enhanced Performance-based Allocation
FSO	Fund for Special Operations
IDA	International Development Association
MDRI	Multilateral Debt Relief Initiative
OC	Ordinary Capital
RMS	Results Measurement System

I. INTRODUCTION

1.1 The 1959 Agreement that established the Inter-American Development Bank also created the Fund for Special Operations (FSO), designed to provide concessional financing to borrowing member countries. The simultaneous creation of the institution and its concessional window was unique among multilaterals.[1] Since then the Bank has maintained its commitment to concessional lending. During the Eight Replenishment (1994-2010), the period covered by this evaluation, the Bank approved 313 projects in five countries using concessional resources totaling US$8.3 billion.[2] These figures corresponded to 22% of the number and 6.5% of the total amount approved by the Bank over the period. IDB-9 provides an additional US$479 million equivalent of new contributions to the FSO.

1.2 Since FSO's inception, eligibility criteria, the degree of concessionality provided, and the formula for allocating resources have undergone several changes, largely driven by the scarcity of resources. In terms of country and project eligibility, while the Charter originally established that the Fund was designed "to make loans on terms and conditions appropriate for dealing with special circumstances arising in specific countries or with respect to specific projects" (Art. IV, Section 1), its resources were increasingly concentrated on the least developed countries, the D countries.[3] The Eight Replenishment narrowed eligibility further, limiting the exclusive use of concessional resources to the five lowest income D2 countries: Bolivia, Guyana, Haiti, Honduras and Nicaragua.[4] These countries are also IDA-eligible.

1.3 During the Eighth Replenishment, the degree of concessionality also changed. The Bank's participation in the Multilateral Debt Relief Initiative (MDRI) launched by the G8 countries in 2005 required a change in the manner in which concessional resources were provided to ensure sustainability. Thus in 2007 the Bank implemented a "blended" structure combining FSO and Ordinary Capital (OC) resources directed at the four HIPC-eligible countries. The specific ratio for each country, and thus the level of concessionality, came to be defined by the risk of debt distress determined by the debt sustainability framework (DSF) developed by the World Bank and the IMF. Haiti was treated in a unique fashion. Given its high risk of debt distress, it became eligible for exclusive grant financing over the entire 2007-2010 period.

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1 The International Development Association (IDA) was established in 1960. The Asian Development Bank's concessional window was created in 1973, seven years after the Bank's establishment. Similarly, the African Development Bank was established in 1964 and its Concessional Window in 1972.

2 These figures include loans to Bolivia, Guyana, Honduras, Nicaragua and Haiti. After 2007 the total includes loans using a blend of FSO and OC resources to the first four countries and 19 grants to Haiti.

3 The D countries included the five countries mentioned as well as the Dominican Republic, Ecuador, El Salvador, Guatemala and Paraguay.

4 Guatemala and Paraguay, the D1 countries, remained eligible for blended resources.

1.4 There have also been major adjustments to the allocation methodology for FSO resources since the Fund's inception. Originally, sectoral and beneficiary criteria were used, generally favoring the social sectors and the poor. As the availability of concessional resources declined, the Bank moved away from funding specific operations in any country to providing resources for a limited number of countries in any sector. Over the period of the Eighth Replenishment, different allocation methodologies were used. Between 1994 and 2001 a needs-based approach was used, with allocation determined by population and GNP per capita. In 2002, country and portfolio performance indicators were combined with the needs' indicators in a linear formula, with the performance indicators given greater weight. The Country Institutional and Policy Performance Evaluation (CIPE), similar to the instrument used by IDA, was introduced to measure country performance. After 2007, in the context of the Multilateral Debt Relief Initiative, the allocation methodology combined two elements: (i) the DSF, used to determine each country's debt-carrying capacity and (ii) the "enhanced performance-based allocation" (EPBA), which combines population, GNI per capita, portfolio performance and policy performance in an exponential formula.

1.5 Most of the changes in the eligibility, degree of conditionality and allocation methodology for FSO resources were driven by the need to allocate scarce concessional resources in the most effective way to maximize social and economic development. However, the Bank did not put in place a system to measure the effectiveness in the use of FSO resources either in the aggregate, at the country level, or at the project level. In the absence of a Bank-wide self-evaluation system to assess development effectiveness, which has only begun to be put in place in recent years, FSO reporting has been largely limited to the amount of resources utilized in any given period.

II. The Evaluation

A. Background and objective

2.1 OVE has carried out two FSO evaluations. The first, "Oversight Note on the Performance Criteria for Allocating Concessional Resources" (RE-279), was presented to the Board of Directors in 2003 and provided a preliminary review of the new performance-related allocation criteria introduced in 2002. In October 2010 OVE presented the "Evaluation of the Fund for Special Operations during the Eight Replenishment (1994-2010) – Part I" (RE-376), in anticipation of the replenishment of the Fund through IDB-9. This document also focused primarily on the implications of the changing methodologies for allocating FSO resources. The emphasis on allocation methodology was viewed as particularly relevant to the Bank's decision-making on how to utilize new resources expected from IDB-9.

2.2 The evaluation found that the introduction of performance based criteria contained an unintended bias against higher need countries: *ceteris paribus*, improvements in performance result in relatively smaller gains in the share of resources going to lower income and/or larger population countries. OVE also pointed to the lack of objectivity and transparency of country performance ratings. Based on these findings, OVE recommended that within-country improvements in policy and institutional performance be factored into the allocation; that the performance indicators become more objective and data-based; and that the results of assessments be disseminated. The evaluation also presented some initial findings on project approval and execution, indicating that despite structural and technical weaknesses FSO-financed projects had shorter preparation times and similar execution to the D1 countries, Guatemala and Paraguay, although they had higher extension and lower cancellation rates.

2.3 The objective of this evaluation is to complete the assessment of the performance of the Bank's FSO loan program during the period of the Eighth Replenishment (1994-2010), focusing as stated in RE-376 on financing and results.

B. Scope of evaluation and methodology

2.4 **Financing**. The evaluation will assess the magnitude and significance of concessional resources to the eligible countries over the period. This will be carried through the calculation of a set of indicators, including the magnitude of FSO resources relative to public expenditures, fixed capital formation and external financing requirements. The magnitude of concessional resources will also be examined at the sectoral level, in an attempt to discern the significance of the IDB in specific sectors in the different countries, and thus its potential contribution to sector outcomes.

2.5 **Results.** The absence of a specific monitoring and evaluation system for FSO lending and the incipient nature of the Bank-wide self-evaluation system pose constraints to the evaluation, most notably in the area of results. This evaluation uses, to the extent possible, the methodology adopted by IDA in its Results Measurement System (RMS), which has also been used by the IDB in the development of the IDB-9 Results Framework. The RMS measures results in the following manner. First the system tracks economic and social development at the country level over time, and compares it to regional results. This reflects the countries' own development efforts and can be used to assess the gap between the least developed countries and the regional average across a range of variables. Second, the system assesses the quality of IDA's operational and organizational effectiveness as a proxy for its contribution to country outcomes. This exercise looks at strategy and project outcome ratings as well as quality at entry indicators for projects, validated by IEG. These results, as well as outputs in four key sectors (health, education, roads transport and water supply), are presented for the active portfolio of IDA projects, without disaggregation by country.

2.6 This methodology will be replicated based on data availability. At the aggregate and country level, the evaluation will assess whether the FSO countries experienced economic and social improvements that have narrowed the gap with other countries in the Region. Indicators in the following categories will be included: (i) growth and debt reduction; (ii) governance and investment climate; (iii) infrastructure; and (iv) poverty and human development, including progress towards the Millennium Development Goals. While overall progress or gains in specific sectors are not attributable to FSO, the weight of FSO financing at the country and at the sectoral level may allow for reasonable inferences about the IDB contribution.

2.7 While data are not available to fully assess FSO's operational and organizational effectiveness over the entire period, following the IDA methodology and the Bank's own Development Effectiveness Framework, the evaluation will compare DEM and PCR ratings for projects. These ratings will be drawn from the IDB's self–evaluation system, themselves not yet validated by OVE and available only since 2008. This will be complemented by other evaluations carried out by OVE, specifically Country Program Evaluations (CPEs). Combined, these data will provide a picture of quality of the FSO portfolio and serve as a proxy for its contribution to country progress.

III. TIMELINE

Activities	Dates
Approach paper to Management	March 2, 2012
Draft document to Management	May 30, 2012
Final version of document to SEC for Board	June 29, 2012