



*RE-412*

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***Approach Paper - Income  
Dynamics in LAC: How is IDB  
Adapting in Higher Middle  
Income Countries?***

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*Office of Evaluation and Oversight, OVE*

Inter-American Development Bank  
Washington D.C.  
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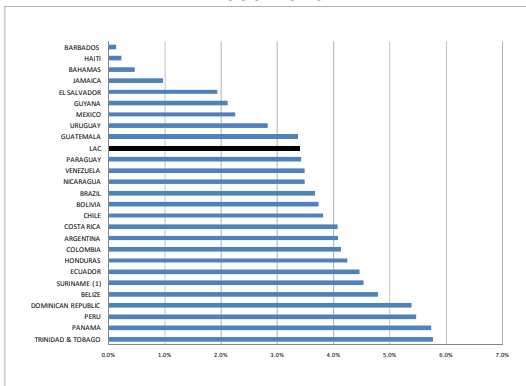
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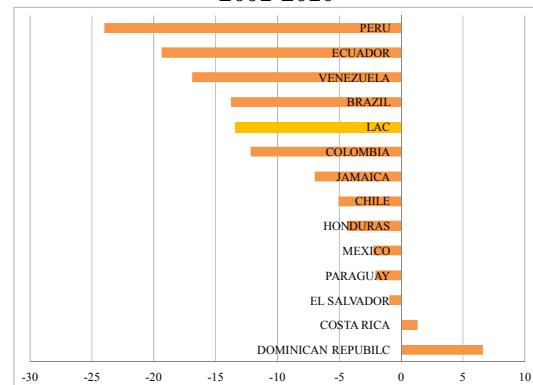
## I. INTRODUCTION: INCOME DYNAMICS IN LAC

- 1.1. Following two decades of lackluster growth, many countries in LAC have witnessed considerable economic growth over the past decade and weathered the recent economic crisis relatively well, thanks to sound macro-economic policies and stronger financial systems. Combined with more progressive social policies, this has resulted in important gains in poverty reduction, declining inequality and important expansions in the size of the middle class.<sup>1</sup> The aggregate poverty rate for the region went down from 44.7% in 2001 to 31.3% in 2010.<sup>2</sup> Likewise, income inequality measured by the Gini coefficient declined from 54 to 50 points during the same period, although inequality and vulnerability remain high in LAC.<sup>3</sup>
- 1.2. However, the regional trends conceal widely different national experiences. For example, there was wide variation in growth rates across the region (Figure 1) over the past decade, with Barbados, Haiti and Bahamas growing at less than 0.5% yearly and Peru, Panama and Trinidad & Tobago growing at yearly rates above 5.5%. Poverty reduction in LAC also shows similar heterogeneity (see Figure 2).

**Figure 1: LAC Average GDP Growth 2000-2010**



**Figure 2: Poverty Rate Variation in LAC 2001-2010**



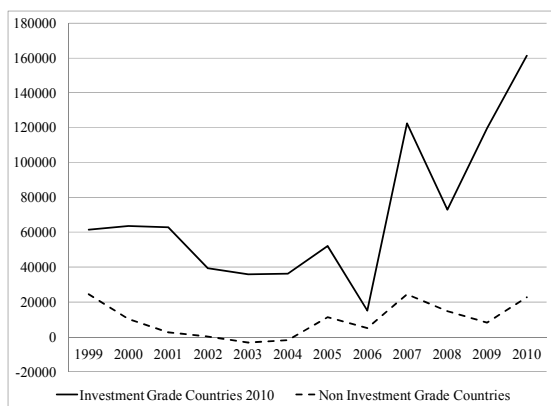
<sup>1</sup> See Lopez-Calva, Luis F. and Nora Lustig (ed.). 2010. Declining Inequality in Latin America: a Decade of Progress? Brookings Institution Press and UNDP; Lopez-Calva, L., and Ortiz-Juarez, E. 2011. "A Vulnerability Approach to the Definition of the Middle Class." Mimeo The World Bank; OECD: Latin American Economic Outlook 2011: How Middle-Class is Latin America

<sup>2</sup> Source: Own calculations using the Poverty Head Count Index statistics from the World Development Indicators Database.

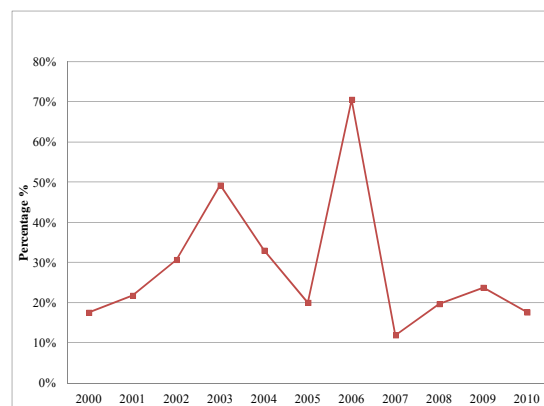
<sup>3</sup> For instance, in 2010 the overall GINI coefficient for LAC was 50; while the same measure was 34 for Middle East and North Africa, 45 for Sub-Saharan Africa, 31 for South-Asia, 40 for East-Asia and the Pacific, and 33 for Europe and Central-Asia (Source: World Development Indicators).

- 1.3. Growing incomes, strengthened macro-economic performance, and increased stability over the past decade have allowed a growing number of governments in LAC to access financial markets at competitive interest rates. While in 2001 five countries in the region had a sovereign debt ratings suggesting investment grade, there now are nine such countries.<sup>4</sup>
- 1.4. Together with the growing importance of other financiers, this has given the more advanced LAC countries a broader range of opportunities to help finance their development investment needs. Indeed, private capital flows to the region have more than tripled from a steady average of US\$ 50 billion up to year 2006 to US\$185 billion in year 2010, with the majority of these resources going to investment grade countries (Figure 3). With the exception of 2003 and 2006, the combined flows from IDB, WB and CAF amounted on average to only 20% of private flows (Figure 4). Yet, as a group, countries with relatively easy access to international capital markets remain a key client group for IDB, accounting for almost 60% of IDB commitments between 2008 and 2010.<sup>5</sup>

**Figure 3: Private Capital Flows to LAC by Investment Grade Country Groups**



**Figure 4: Share of Flows from IDB, World Bank and CAF with respect to Private Capital Flows to LAC**

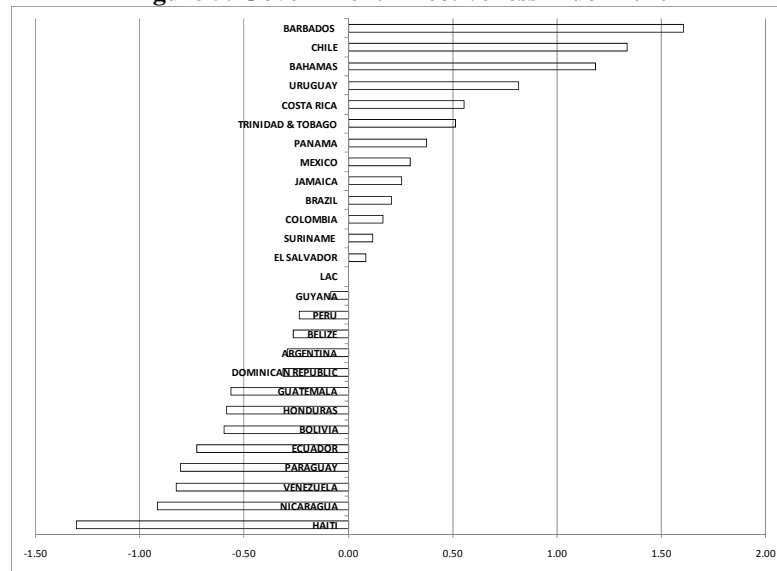


- 1.5. Rising incomes and an expanding middle class are also correlated with enhanced institutional effectiveness, as knowledge, human capital, and resources expand in a country. Yet, as with income, there is considerable variation in institutional capacity across IDB's client countries. For example, Figure 5 displays the Government Effectiveness Index from the World Bank-Worldwide Governance Indicators for each country, normalized with respect to the LAC average. Countries like Haiti, Nicaragua and Venezuela show weaker capacity, while countries like Barbados, Chile and Bahamas show solid effectiveness.

<sup>4</sup> In 2001 Bahamas, Barbados, Chile, Trinidad & Tobago and Uruguay were classified as Investment Grade Countries. Currently, in addition to those countries, also Brazil, Colombia, Mexico and Peru are classified as Investment Grade Countries.

<sup>5</sup> ie. Bahamas, Barbados, Brazil, Chile, Colombia, Mexico, Peru, Trinidad & Tobago and Uruguay

**Figure 5: Government Effectiveness Index 2010**



- 1.6. The changing financing landscape, substantial variation in institutional capacity, and changing development needs associated with rising incomes and an expanding middle class present new challenges to IDB as a development finance partner. The growing heterogeneity in economic power, institutional capacity, and access to financial markets across the region will increasingly demand a differentiated mode of IDB engagement across various client groups.
- 1.7. Accordingly, this evaluation will seek to assess how well IDB has adapted to changing client needs, particularly in countries with higher incomes which often have access to international financial markets and where IDB financing is a relatively minor share of financial flows and GDP. The evaluation will assess how well IDB is positioned to meet these changing client needs.

## II. EVALUATION QUESTIONS

- 2.1 The main objective of the evaluation is to assess IDB's responsiveness and adaptability to the capacities and demands of countries with relatively higher income levels and sizeable middle classes. For the purpose of this evaluation, these countries are labeled as Higher Middle Income Countries (HMIC). The evaluation will focus on how well IDB has adapted to changing client needs in terms of its business model, financial instruments, and knowledge products. The specific evaluation questions and sub-questions are as follows:
  - 2.2 **How has IDB adapted its business model to the evolving needs of client countries?**
    - What is the role of country strategies in IDB's engagement with client countries?

- How does the portfolio of engagement differ across various country contexts?
- What role do “Country Systems” play in IDB’s engagement with Higher Middle Income Countries?<sup>6</sup>
- How does IDB’s business model in Higher Middle Income Countries compare to that of other International Financial Institutions (IFI)?

**2.3 How well are IDB’s financial instruments suited to the evolving needs of clients?**

- How well do IDB’s financial instruments meet client expectations?
- What has been the role of non-sovereign lending in helping countries meet evolving development challenges?
- How do IDB’s financing instruments compare to those offered by other IFIs?
- To what extent do IDB financial instruments complement those available for countries with access to international financial markets?
- What is the financial competitiveness of IDB’s products in different country contexts?

**2.4 How effectively does IDB share knowledge in Higher Middle Income Countries?**

- What have been the results of IDB supported knowledge products in Higher Middle Income Countries?
- How effectively is IDB applying global knowledge to country programs and projects in these countries?

### **III. APPROACH AND DATA SOURCES**

3.1 The evaluation will use a mixed methods approach, drawing on a variety of building blocks. The evaluation matrix in Annex 1 spells out in detail what instruments will be used to answer each of the above questions.

3.2 The analysis of how well IDB has adapted to new challenges and demands arising from higher incomes and client capacity in the region will draw on five building blocks, including (i) country case studies, (ii) a review of OVE CPEs, (iii) structured interviews with country stakeholders, Board members and IDB staff and managers, (iv) thematic background notes, and (v) a comparative portfolio analysis.

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<sup>6</sup> Country systems as defined here includes procurement, financial management, monitoring and evaluation and safeguards systems.

- 3.3 **Country Case Studies:** The evaluation will perform field based country case studies in up to ten countries. Case study countries are selected based on three characteristics. The first is GDP per capita, representing income level. The second is the S&P Sovereign Debt Rating as of March 2012, which is used as a proxy for access to international financial markets. The third is the share of IDB commitments between 2008 and 2010 flowing to the country, which reflects the weight of the country in IDB's lending portfolio. For each country, an equally weighted average index is calculated on the basis of these three measures. The ten top ranked countries are chosen for case studies and include Argentina, Brazil, Chile, Colombia, Mexico, Panama, Peru, Trinidad and Tobago, Uruguay and Venezuela (see Table 1).
- 3.4 Case studies will look at how well country strategies serve to guide IDB engagement in the country, how IDB has engaged in the country in the face of growing incomes, client sophistication and clients' access to alternative financing sources, what instrument mix IDB has used and how well the instruments were suited to help clients tackle core development challenges, how well IDB's engagement complements that of other international and regional financiers and the international capital market, the role and effectiveness of knowledge products, and progress on use of country systems. Country case studies will utilize a unified evaluation template to allow information to be organized in comparative fashion across all case studies.

**Table 1: Country Selection**

COUNTRY	GDP per capita 2010 (USD PPP)	GDP Yearly Growth (2000-2010 Average)	April 2012 S&P Sovereign Debt Rating (foreign currency)	Country Commitment as share of total IDB commitments (2008-2010)	OVE Index
MEXICO	12,441	2.2%	BBB	18.5%	0.00
BRAZIL	10,056	3.7%	BBB	21.8%	0.05
ARGENTINA	14,363	4.1%	B	10.0%	0.07
PANAMA	12,207	5.7%	BBB-	4.2%	0.11
CHILE	13,596	3.8%	A+	1.8%	0.12
COLOMBIA	8,488	4.1%	BBB-	7.9%	0.16
VENEZUELA	10,973	3.5%	B+	4.8%	0.18
TRINIDAD & TOBAGO	23,080	5.8%	A	0.5%	0.19
URUGUAY	12,903	2.8%	BBB-	2.0%	0.21
PERU	8,555	5.5%	BBB	2.5%	0.27
BARBADOS	17,564	0.1%	BBB-	0.5%	0.28
DOMINICAN REPUBLIC	8,387	5.4%	B+	3.5%	0.30
COSTA RICA	10,378	4.1%	BB	2.5%	0.30
EL SALVADOR	5,981	1.9%	BB-	3.3%	0.39
ECUADOR	7,201	4.5%	B-	2.7%	0.42
GUATEMALA	4,292	3.4%	BB	3.2%	0.44
JAMAICA	6,882	1.0%	B-	3.1%	0.44
BAHAMAS	22,770	0.5%	n.a.	0.3%	0.47
PARAGUAY	4,647	3.4%	BB-	1.3%	0.57
SURINAME	6,930	4.5%	BB-	0.3%	0.62
BOLIVIA	4,350	3.7%	B+	1.2%	0.62
HONDURAS	3,519	4.2%	B	1.3%	0.64
BELIZE	5,988	4.8%	CCC-	0.2%	0.76
NICARAGUA	2,614	3.5%	n.a.	1.2%	0.92
HAITI	996	0.2%	n.a.	1.1%	0.97
GUYANA	3,080	2.1%	n.a.	0.3%	1.00

**Note:** OVE index comprises an equally weighted average of country rankings with respect to GDP per capita 2010, S&P sovereign risk rating in foreign currency, and the share of IDB 2008-2010 commitments flowing to each country. OVE index is normalized between 0 and 1; where 0 indicates a higher rank and 1 being the lowest.

3.5 **Structured interviews:** Structured interviews will be conducted with client stake holders in all case study countries to glean how demands from client countries are changing, how well clients consider that IDB’s lending instruments and knowledge products meet their needs, and what the value of country strategies and programming is from the client’s perspective. Similar interviews will be carried out with selected IDB managers and staff and with country client representatives serving in the offices of IDB executive directors. Interview protocols will be developed to allow for systematic analysis of interview results.



- 3.6 **Systematic review of OVE Country Program Evaluations:** Over the last three years, OVE has completed eighteen CPEs, and another three will be completed in 2012. These will be systematically analyzed for findings on relevance and effectiveness of IDB engagement, relevance of lending instruments utilized, relevance and value added of knowledge products, and potential patterns in the nature of engagement across various groups of IDB clients.
- 3.7 **Thematic Background Notes:** A number of thematic background notes will be commissioned to review core issues in-depth, including (i) a note assessing the adequacy of IDB lending instruments compared to those of other relevant financiers; (ii) a note on loan pricing and competitiveness of IDB products; (iii) a note assessing the relevance and effectiveness of knowledge products; (iv) a note assessing progress on the use of country systems; (v) a note on the business model adopted by other IFIs in UMICs; and (vi) a note on the role of NSG lending to the private sector. Notes (i), (iii), (iv) and (vi) will be prepared in an iterative fashion. In a first instance, relevant corporate and country specific documents will be reviewed. Each note will then devise a theme specific module to be integrated into the country case studies. Once country case study materials become available, theme specific relevant information will be culled across all country case studies and integrated into thematic notes. Where relevant, information from interviews will also be integrated. Notes (i)-(iv) will also serve as inputs to OVE's ongoing IDB9 evaluation.
- 3.8 **Comparative Portfolio Analysis:** To assess to what extent IDB is taking a differentiated approach across countries, IDB's client countries will be grouped into four categories based on income level and public sector institutional capacity. Three countries from each group will be selected, and IDB's portfolio over the past five years will be analyzed with respect to instrument use (including TC), sovereign vs. non-sovereign lending, and core focal areas of support to discern to what extent the nature of IDB engagement and instrument mix varies with income and institutional capacity.
- 3.9 **Coordination with other OVE evaluation:** The present study will draw on and contribute to other evaluation work ongoing or recently completed in OVE. Several key focal topics of this report will also be covered under the IDB9 evaluation, thus allowing for synergies across the two products. The present evaluation will also draw on OVE's recently completed evaluation of non-sovereign lending at sub-national level and Country Program Evaluations completed over the last several years.

#### IV. TEAM AND TIMELINE

- 4.1 Evaluation Team: The evaluation team will be led by Diether Beuermann and will include Pablo Alonso, Hector Conroy, Monika Huppi, Jose Ignacio Sembler, Diego Vera, and several external consultants.
- 4.2 **Delivery Timetable:**

<u>Activity</u>	<u>Date</u>
<b>1. Approach paper</b>	
a. Send to Board	May 1, 2012
<b>2. Implementation</b>	May – November, 2012
<b>3. Evaluation Report</b>	
a. Send to Management	November 30, 2012
b. Send to Board	December 21, 2012

**Annex 1: Evaluation Matrix**

Evaluation Question	Sub-question	Approach	Comments
<p><b>How has IDB adapted its business model to the evolving needs of client countries?</b></p>	<p>What is the role of country strategies in IDB’s engagement with client countries?</p>	<ul style="list-style-type: none"> <li>• Systematic review of OVE CPEs</li> <li>• Comparison of alignment of country strategies with annual programming and actual implementation in case study countries</li> <li>• Structured interviews with country stakeholders and board representatives</li> <li>• Structured interviews with IDB staff</li> </ul>	<p>Review undertaken in coordination with IDB9 evaluation.</p>
	<p>How does the portfolio of engagement differ across various country contexts?</p>	<ul style="list-style-type: none"> <li>• Comparative Portfolio Analysis</li> <li>• Review of OVE CPEs</li> </ul>	
	<p>What role do “Country Systems” play in IDB’s engagement with Higher Middle Income Countries?</p>	<ul style="list-style-type: none"> <li>• Background paper on use of country systems (Financial Management, Procurement and M&amp;E): review of approach and implementation progress, results achieved in selected case study countries, linkages with capacity building.</li> <li>• Background paper on use of country systems for social and environmental safeguards: review of approach taken, implementation progress and results in selected countries, linkages with capacity building.</li> </ul>	<p>Background papers will also inform IDB9 evaluation</p> <p>Mexico case study will also inform Mexico Country Program Evaluation</p>
	<p>How does IDB’s business model in Higher Middle Income Countries compare to that of other International Financial Institutions (IFI)?</p>	<ul style="list-style-type: none"> <li>• Analysis of business model adopted by CAF, WB, ADB and EIB</li> </ul>	

Evaluation Question	Sub-question	Approach	Comments
<b>How well are IDB's financial instruments suited to the evolving needs of clients?</b>	How well do IDB's financial instruments meet client expectations?	<ul style="list-style-type: none"> <li>Review of financial instruments offered by other IFIs particularly those geared at UMICs with access to financial markets</li> </ul>	Work will also inform IDB9 evaluation
	What has been the role of non-sovereign lending in helping countries meet evolving development challenges?	<ul style="list-style-type: none"> <li>Structured interviews with country stakeholders in case studies</li> <li>Interviews with IDB staff</li> <li>Portfolio review of NSG lending in case study countries</li> </ul>	
	How do IDB's financing instruments compare to those offered by other IFIs?	<ul style="list-style-type: none"> <li>Background notes on instruments and business models of other IFIs</li> </ul>	
	To what extent do IDB financial instruments complement those available in the financial market for countries with access to international financial markets?	<ul style="list-style-type: none"> <li>Review of relative importance of IDB financial flows and instruments</li> <li>Country case studies</li> </ul>	
	What is the financial competitiveness of IDB's products in different country contexts?	<ul style="list-style-type: none"> <li>Analysis of financial terms of IDB products in comparison to those by comparator institutions and financial market in various country contexts</li> </ul>	Work to be carried out as part of IDB-9 evaluation
<b>How effectively does IDB share knowledge in Higher Middle Income Countries?</b>	What have been the results of IDB supported knowledge products in Higher Middle Income Countries?	<ul style="list-style-type: none"> <li>Structured interviews with country stakeholder in the context of case studies</li> </ul>	
	How effectively is IDB applying global knowledge to country programs and projects in these countries?	<ul style="list-style-type: none"> <li>Country case studies</li> <li>Systematic review of OVE CPEs</li> <li>Structured interviews with IDB Staff</li> </ul>	