



Approach Paper

Oversight Study: The Evolution of Administrative Spending in the Inter-American Development Bank



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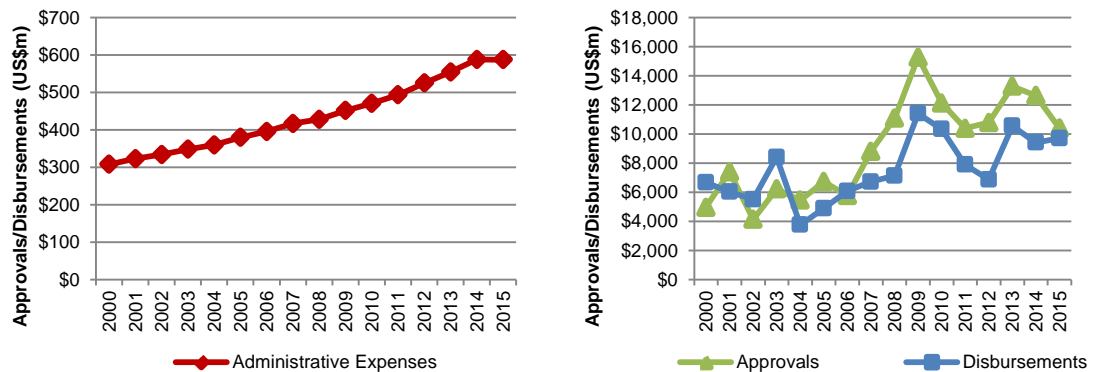
ACRONYMS AND ABBREVIATIONS

ABB	Agenda for a Better Bank
ASABE	Annual Salary Adjustment Budget Envelope
CAP	Capital Adequacy Policy
FSO	Fund for Special Operations
IDB	Inter-American Development Bank
IDB-9	Ninth General Capital Increase of the IDB
IMM	Income Management Model
LAC	Latin America and the Caribbean
MDBs	Multilateral Development Banks
NASV	Net Average Salary Variance
OC	Ordinary Capital
OVE	Office of Evaluation and Oversight
TC	Technical Cooperation

I. MOTIVATION

1.1 **Administrative spending in the Inter-American Development Bank has almost doubled since the early 2000s, from US\$308 million in 2000 to US\$588 million in 2015 in nominal terms.**¹ During the same period, lending and disbursements have fluctuated (especially around the financial crisis) but seem to have plateaued recently (Figure 1.1), whereas loan income has been decreasing (Figure 1.2). While there have been efforts to discipline spending² – a notable one being the Cancun Declaration of 2010,³ in which the Governors adopted the Income Management Model (IMM) that required the Bank to cover 90% of its expenses with current income,⁴ the pace of increase has been relatively steady.

Figure 1.1 Administrative Expenses,* Approvals, and Disbursements, 2000-2015



* Administrative Expenses: Excluding retirement contributions and benefits.
 Source: Budget Execution Reports and Annual Reports

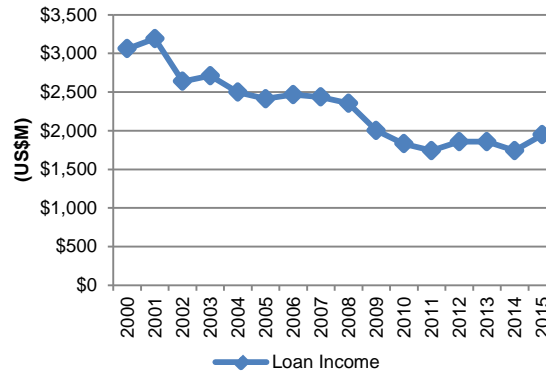
¹ The figures for administrative expenses cited here exclude post-retirement benefits and contributions to IDB retirement plans. Not only are these items highly variable and unpredictable from year to year, but for several years the Bank has separated them out from its administrative budget. These items may be included in the evaluation's analysis as needed (including for comparability with other institutions).

² For example, Management estimated that the reforms introduced by the Realignment in 2007 would "generate annual savings in an indicative range of 5% to 7%" (GA-232, para. 9.4, p. 53 and GA-232-12, p. 46). Similarly, Management has adopted a number of cost saving and cost avoidance initiatives that, according to their own calculations, have yielded US\$98.5 million of savings since 2008 (GA-258-13).

³ AB-2728, para. 8.

⁴ AB-2764, para. 4.17 and Annex 2. The Governors approved the IMM at a time when the Bank's administrative budget was growing fast and new capital was needed to support the Bank's increasing lending program. The IMM established that the Bank's income should cover at least 90% of OC administrative expenses, other borrowing expenses, the TC Special Programs, the agreed annual transfers to Haiti, other income uses, and other capital needs to maintain the AAA rating according to the Capital Adequacy Policy (CAP) (FN-568-8, updated in 2015 with AB-2996). These parameters were meant to work in an interrelated, comprehensive and simultaneous approach to help rationalize the allocation of resources and allow capital to grow over time through the retention of income.

Figure 1.2 Loan Income, 2000-2015



Source: Budget Execution Reports and Annual Reports

- 1.2 **The rise in administrative spending has added to pressures on the Bank’s capital position, at the same time as several LAC countries have seen ratings downgrades and reduced lending envelopes from the Bank due to deteriorating economic situations.**⁵ To boost capital in the near term, the Bank must generate net income by either increasing income or decreasing expenses. In 2015 the Bank raised the lending charges that borrowers must pay, making borrowers acutely aware of the costs to them of the Bank’s rising administrative budget. The Board of Directors then mandated a budget cut for 2016 – the first in the Bank’s recent history.
- 1.3 **Going forward, the Board is interested in exploring ways for the Bank to continue to reduce costs and increase efficiency.** As part of OVE’s work program and budget discussion for 2016-17, the Board requested that OVE include in its 2016 program a review of the Bank’s administrative spending, with a goal of helping the Board and management identify opportunities for cost reductions. The review proposed in this approach paper responds to that request.

II. SCOPE AND REVIEW QUESTIONS

- 2.1 **This exercise is not meant to be an evaluation per se, but rather an activity that fits more broadly under OVE’s oversight mandate.** OVE’s goal is to shed light on cost patterns and trends to help the Board and management in their decision-making and governance roles. For a number of reasons OVE does not believe it would be feasible to undertake a full analysis of IDB efficiency in the time available,⁶ though it should be possible to illuminate IDB spending patterns

⁵ It should be noted that some leading rating agencies have hardened their methodology to gauge capital since the introduction of the IMM, which has also added to the capital pressures.

⁶ The evaluation of an organization’s efficiency is usually a very challenging endeavor due to difficulties of measuring inputs, outputs, and outcomes and of determining optimal input-output mixes. See Chote.

and trends and undertake some broad comparisons with partner multilateral development banks.

2.2 **This review is meant to be a descriptive rather than a normative analysis.**⁷
Thus OVE does not intend to provide formal recommendations.

2.3 **Due to the need for comparability, the review will focus on spending trends from 2008 onwards, as 2008 was the first year of the new post-Realignment structure.** When necessary and to capture contextual changes or important decisions that may have affected spending patterns, OVE will analyze data from 2000 onwards.

2.4 **Data for the analysis will be drawn from the Bank's databases and reports.** These include the Enterprise Data Warehouse (EDW), HRD Analytics, administrative budget (BUD-E/SAP), Convergence, procurement (PRISM), use of staff time (T&L), Loan Management System (LMS), and IDBDocs. Subject to data availability, OVE will seek to establish a dataset of key expenditure information from comparator organizations to benchmark the Bank's cost structure.

2.5 **OVE plans to address the following interrelated and complementary questions:**

i. **How has the Bank's cost structure evolved over time? What are some key drivers of these trends?**

For this analysis OVE will focus in particular on the main business functions; the various organizational units in VPF, VPS, VPC, VPP and the corporate core; specific types of spending (such as staff salaries,⁸ consultant costs, travel, and information technology); and the governance and oversight structure of the Bank. Special attention will be paid to the context in which these patterns have occurred and key drivers of expenditures.

ii. **How have the relationships between inputs and outputs in various types of Bank activities evolved over time? What are some key drivers of these trends?**

For this analysis OVE will focus on key development-related tasks (such as lending and technical cooperation) and support functions (such as human resources, legal, etc.).

R., Emmerson. C., Simpson, H. 2003. *The IFS Green Budget*. Institute for Fiscal Studies, London; Levin, H. M., and McEwan, P. J. 2001. *Cost-Effectiveness Analysis*. 2nd ed. Sage. London; Coelli, T. O'Donnell, C., and Battese, G. 2005. *An Introduction to Efficiency and Productivity Analysis* 2nd ed. Springer. NY; Stone, M. 2002. How not to measure the efficiency of public services (and how one might), *Journal of the Royal Statistical Society*, vol. 165, issue 3, pp. 405–34

⁷ In this way it resembles OVE's recent technical analyses of policy-based and contingent lending in IDB.

⁸ This evaluation will not review the structure of the Bank's compensation and benefits system, as management has retained an external firm for this purpose.

iii. **How might budget processes, systems, and policies influence the Bank's expenditure patterns?**

For this analysis, OVE will focus on key policies (including outsourcing initiatives), processes, systems, incentives, and reporting instruments used to manage Bank resources and, data permitting, will also seek to compare them with suitable best practices.

iv. **How do patterns and trends in IDB administrative spending, income generation, and input-output ratios for key products compare to those in partner multilateral development banks?**

For this analysis OVE will seek to gather information from the World Bank and, data permitting, the CAF (the two other MDBs most active in the LAC region) and the Asian Development Bank (the MDB most similar in size and mandate to IDB).

III. TEAM AND TIMELINE

- 3.1 The review team is composed of Pablo Alonso, Monika Huppi, Alejandro Soriano, Jonathan Rose, Anna Crespo, Miguel Soldano, María Fernanda Rodrigo, Ernesto Cuestas and Nayda Ávalos. A draft of the review is expected to be available for management review in September 2016, and the final review is expected to be delivered to the Board in October 2016.