Office of Evaluation and Oversight

Mid-term Evaluation of IDB-9 Commitments

Lending Instruments

Background Paper

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ABSTRACT

The IDB-9 Agreement asks whether the financial instruments of the Inter-American Development Bank (IDB, or Bank) are properly aligned with the needs of clients. Before the global financial crisis, the Bank's concern was with the competitiveness of IDB financing; as borrowers gained increased access to global capital markets, the price advantage that IDB had in terms of lower interest rates and higher maturities was often outweighed by the high transaction costs of borrowing from IDB. With the advent of the crisis, the dynamic changed—it was no longer a question of whether there was demand for IDB funding, but whether IDB could provide funding with the speed and at the levels that the crisis dictated. This evaluation examines IDB's lending instruments from both these perspectives.

Since 2000 IDB has added a large number of investment instruments in an effort to lower transaction costs and address specific needs of its borrowers. The range of investment lending instruments equals or exceeds that of other multilateral development banks. More recently Management has been working to streamline these instruments and eliminate those that are being only intermittently used: the innovation loan and sector facilities have been discontinued, and the performance-driven loan was allowed to lapse after the pilot period, pending further review and evaluation. The Bank has made significant progress on reducing the time lapse from concept stage to loan approval for all instruments, substantially lowering transaction costs.

The story is more problematic with regard to IDB's ability to respond to the needs of borrowers during a crisis. A special instrument created for this purpose met with limited take-up: only five operations were approved, and three of them were cancelled. IDB has recently adopted contingency lending instruments that should allow for a more timely response to economic crises or natural disasters. One tool that IDB still lacks is a viable lending instrument that disburses against the achievement of results.

PREFACE

The Inter-American Development Bank (IDB) is in a period of rapid change, responding to both the economic dynamism of the Region it serves and the increasing competition in the international financial marketplace. Over the past decade, countries in Latin America and the Caribbean have gained greater access to alternative sources of finance and an increasingly ability to generate and share knowledge among themselves. Like other multilateral development banks, IDB is seeking to adapt to this changing international landscape by ensuring that it is responsive to borrowing countries' needs and putting strong emphasis on effectiveness in its use of scarce resources.

In 2010 the IDB's Board of Governors approved the 9th General Capital Increase of the IDB (IDB-9). The IDB-9 Agreement laid out a series of reforms intended to strengthen the strategic focus, development effectiveness, and efficiency of the IDB to help it remain competitive and relevant in the years ahead. As part of that Report, IDB's Office of Evaluation and Oversight (OVE) was charged with conducting a midterm evaluation—to be presented to the Board of Governors in March 2013—to assess IDB's progress in implementing those reforms. The full evaluation is available at www.iadb.org/evaluation.

This paper is one of 22 background papers prepared by OVE as input to the IDB-9 evaluation. It seeks to determine whether one portion of the IDB-9 requirements has been implemented fully and effectively and to offer suggestions to strengthen implementation going forward. The overarching goal of this paper and the entire evaluation is to provide insights to the Governors, the Board, and IDB Management to help make IDB as strong and effective as possible in promoting economic growth and poverty reduction in Latin America and the Caribbean.

TABLE OF CONTENTS

This paper was prepared by Basil Kavalsky and Jose Ignacio Sembler under the general guidance of Diether Beuermann and Monika Huppi. All background papers were thoroughly reviewed and discussed within OVE and shared with IDB Management for comments. The other background papers and full IDB-9 evaluation can be found at www.iadb.org/evaluation.

ABBREVIATIONS AND ACRONYMS

CCL	Contingent Credit Line for Natural Disasters
CCLIP	Conditional Credit Line for Investment Projects
CPE	Country Program Evaluation
DSL	Development Sustainability Credit Line
FFF	Flexible Financing Facility
GDP	Gross domestic product
IDB	Inter-American Development bank
IDB-9	Ninth General Capital Increase of the IDB
MDB	Multilateral development bank
OVE	Office of Evaluation and Oversight
PBL	Policy-based loan
PBP	Programmatic policy-based loan
PDL	Performance-driven loan
SG	Sovereign guarantee
SIL	Specific investment loan

EXECUTIVE SUMMARY

The IDB-9 Agreement calls on the Inter-American Development Bank (IDB, or Bank) to undertake a review of lending instruments, both to eliminate unnecessary instruments and to identify gaps or new instruments that IDB should consider adopting. The Office of Evaluation and Oversight (OVE) finds that Management has moved to meet this requirement, albeit somewhat slowly. The effectiveness of implementation appears mixed to date but seems to be heading in a positive direction.

Since 2000, in an effort to increase its competitiveness and reduce the transaction costs of its loans by streamlining processing times and fiduciary requirements and by introducing new instruments designed to bypass particular constraints, the Bank has created an array of investment lending instruments. These new instruments took two forms: some used a "programmatic" approach to facilitate multiple loans if interim targets are met, while others emphasized flexibility to support pilot or innovative activities more quickly than standard loans.

As a result of this expansion, IDB offers its borrowers an array of investment lending instruments equal to or wider than that of the other multilateral development banks. The consensus among practitioners is that this is not a problem but an advantage—that having a substantial menu from which borrowers can pick is positive. Indeed, experience suggests that country needs and characteristics drive instrument choice—countries experiment with a new lending modality and, if the experience is positive, tend to stay with that modality as their primary form of interaction with IDB. Yet the large number of instruments does raise the question of whether streamlining might allow more focused decision-making on instrument choice at the country level.

The issue of instruments was further complicated with the advent of the global financial crisis in 2008. It was no longer a question of whether there was demand for IDB funding, but instead whether IDB could provide funding with the speed and at the levels that the crisis dictated. Lending increased to US$10 billion in 2008 and US$15 billion in 2009, precipitating the need for a general capital increase. In principle the capital increase allows the IDB to play an enhanced role in times of crisis, but its instruments were not ideal for that purpose.[1] An unprecedented series of natural disasters between 2008 and 2010 also led to calls for IDB to develop lending products to support quick response.

In response to the IDB-9 requirements and experience during the global crisis, in 2011 Bank Management undertook an analysis of the Bank's sovereign-guaranteed instruments. In December 2011 the Board approved a "Proposal to Reform the Bank's Sovereign Guaranteed Lending Instruments" (GN-2564-3), eliminating two instruments,

[1] In 2008, in response to the international financial crisis, IDB introduced a Liquidity Program for Growth Sustainability to provide liquidity up to US$500 million per country to "regulated financial institutions facing reduced access to foreign credit lines and interbank credit." The program was transitory, expiring on December 31, 2009. Because the funds for this program would come from emergency lending resources, there would be no opportunity cost in terms of the Bank's normal lending program for investment and policy-based loans. Between 2007 and 2011, the Bank approved five financial emergency operations, but three were subsequently cancelled.

innovation loans and the sector facility framework. Management also moved to address the need for a strong contingent lending instrument for crisis situations that would be more effective than the previous instrument. In October 2012, IDB's Board of Governors approved two new instruments: the Development Sustainability Credit Line, designed to protect poverty-related programs in the event of external shock, and the Contingent Credit Line for Natural Disasters, designed to complement the Contingent Credit Facility for Natural Disasters and provide additional resources in the event of natural disasters. In addition the Governors' decision authorized the use of the deferred drawdown option for regular policy-based operations to allow countries to obtain approval of their allocation of policy-based loans in a given year but have access to the resources in amounts, and at the time, that meets their needs most effectively.

In addition to lending instruments, IDB's Articles of Agreement authorize it to offer guarantees to borrowers. Until 2005 the use of guarantees was limited to the private sector. In 2004 the Board approved guidelines for local currency guarantees to public sector entities. Only two such guarantees have been made to date. Both were designed to provide assurances to private participants in public-private partnership operations that the public sector would meet its contractual obligations, thus making it possible to attract well-qualified international companies to build and operate infrastructure in Peru and Guyana. The use of the guarantee instrument was recently extended to support debt restructuring in Panama.

The key remaining gap in IDB's range of instruments appears to be the absence of a viable instrument that disburses against results. The performance-driven loan, piloted in 2003, had little demand from Borrowers due to its requirement that disbursements be linked not only to results but also to evidence of the specific investment expenditures undertaken for the achievement of those results, with only those contracts that conformed to IDB procurement procedures eligible for reimbursement. OVE suggests that Management establish a working group to review other MDB's experience with program loans that disburse against the achievement of results and to assess whether it would be useful for IDB to add an instrument along these lines. A well-designed instrument of this type could be of considerable interest to IDB's borrowers.

I. INTRODUCTION

A. Background and context

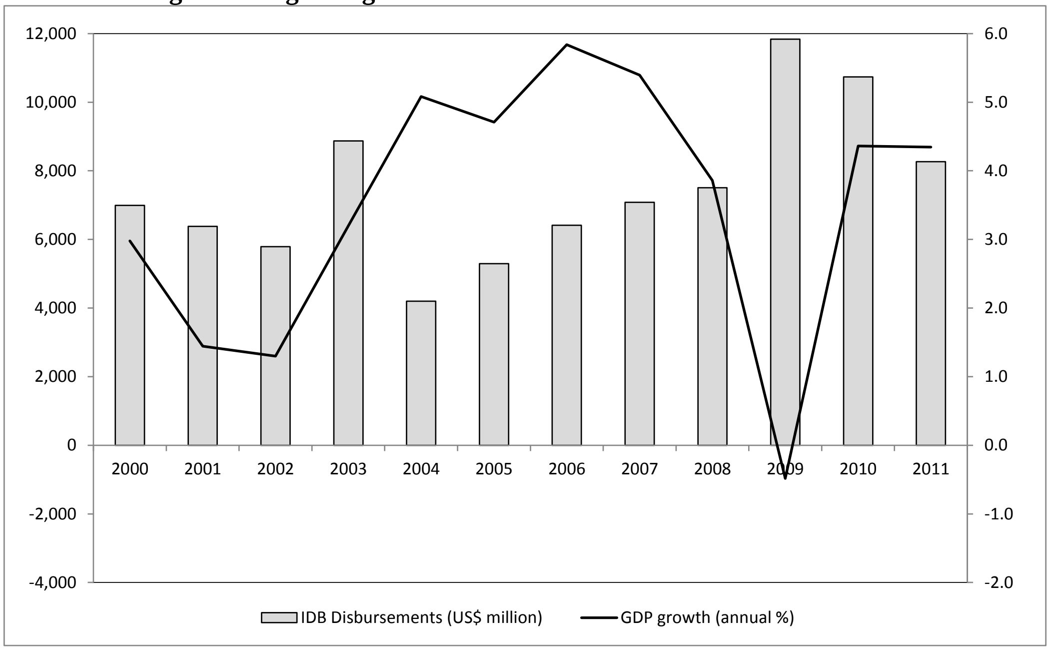
1.1 As growth rates in Latin America and the Caribbean accelerated over the past 10-15 years, concern arose that the Inter-American Development Bank (IDB, or Bank) was becoming less and less competitive as a source of development funding. In 2006 Mexico prepaid half of its outstanding loans from the Bank, and overall lending stagnated at US$5-6 billion a year, well below the projection of US$8 billion a year made in the New Lending Framework for 2003-2008. As borrowers gained increased access to global capital markets, the price advantage that IDB had in terms of lower interest rates and longer maturities was often outweighed by the high transaction costs of borrowing from IDB—loans took more than 400 days on average to move from the concept stage to approval, and fiduciary requirements imposed cumbersome implementation procedures that bore no relation to the countries' own systems. At the same time, the donor community was placing increased emphasis on safeguards and social objectives while also trying to foster a new culture of results, requiring close monitoring of project outputs, outcomes, and impact.

1.2 Starting around 2000, these factors led IDB's Management to explore ways of reducing transaction costs, both directly by speeding up processing and simplifying fiduciary requirements, and indirectly by introducing new instruments that were specifically designed to deal with some of these constraints. These new instruments took two forms: instruments that used a "programmatic" approach, allowing progressive funding for new activities as borrowers met a set of targets or triggers; and smaller, more flexible instruments that could be used for pilot or innovative operations that would be executed more quickly than standard loans.

1.3 With the advent of the global financial crisis in 2008, the dynamic changed. It was no longer a question of whether there was demand for IDB funding, but instead whether IDB could provide funding with the speed and at the amounts the crisis dictated. In 2008 lending increased to US$10 billion and in 2009 to US$15 billion, precipitating the need for a new general capital increase. An unprecedented series of natural disasters between 2008 and 2010 also led to calls for IDB to develop lending products to support a quick response to these events.

1.4 This combination of concerns—about whether IDB could respond at adequate speed and cost to the needs of borrowers and about the need for countercyclical and emergency lending—appears to have led to the IDB-9 requirement of a review of whether the Bank's array of lending instruments meet borrowers' "needs and expectations." Figure 1 shows that, in practice, IDB's lending has been countercyclical: when borrowers have easy access to global capital markets, and remittances and foreign direct investment are relatively abundant, demand for IDB resources declines, and in periods such as the global financial crisis it picks up again. It is notable however, that a major share of the increased disbursements in 2008 and 2009 went to just two countries, Brazil and Mexico. For the rest there was little change, so that concerns about whether IDB is able to respond to cyclical demand remain valid. There was limited demand for a special program introduced by IDB to try to increase flows to borrowers during the global financial crisis, without reducing other IDB lending (discussed later in the paper).

Figure 1. Regional growth trends and IDB disbursements



Sources: World Development Indicators (World Bank), Department of Finance (IDB).
Notes: GDP growth = simple average growth rates for the 26 IDB countries.

1.5 During the IDB-9 negotiations, in addition to general concerns about the appropriateness of lending instruments there was also discussion of the adequacy of IDB support for innovation. Lending instruments may not be the right context for a review of this topic. Much of IDB's support for innovation is through the Multilateral Investment Fund and its nonreimbursable technical cooperation. Sovereign-guaranteed (SG) loans can and do support innovation as well, but more as a matter of the components of particular loans than of the nature of the lending instrument. While since 2000 IDB has had an instrument explicitly entitled an innovation loan, experience has been that the basic rigidities of the loan and project cycle do not result in cost or time savings for processing small loans. (This is discussed further below.)

B. IDB-9 requirements

1.6 The intention of the Governors in the IDB-9 Agreement seems to have been that Management should undertake a review of lending instruments with two objectives: first, to streamline them and eliminate unnecessary instruments; and second, to identify gaps or new instruments that IDB should consider adopting. In Management's words:

> The Bank's lending instruments need to effectively support development purposes and reflect changing country needs and context. Over the last years the Bank has created an array of lending instruments that have focused more on administrative processes than on supporting development outcomes. While the current lending categories of policy-based and investment loans will be maintained, a review of existing instruments will consider simplifying the menu of instruments and updating administrative policies to emphasize development results, and tailoring instruments to specific needs. The Bank's annual programming document will reflect the alignment of the project pipeline with the Country Strategy that provides the development framework, including the macro-fiscal framework, for the country.

1.7 While the Governors were not explicit in defining this issue in terms of SG lending instruments, it appears from the context that this was the primary focus of their concern. (Issues concerning the adequacy of the instruments available to meet the needs for non-sovereign-guaranteed lending are discussed in the background paper addressing the private sector).

C. Purpose and methodology of the evaluation

1.8 The IDB-9 Agreement asked the Office of Evaluation and Oversight (OVE) to evaluate to what extent the Bank had fully and effectively implemented the requirements. To carry out this task, OVE (i) gathered detailed information on the use of different instruments; (ii) interviewed project team leaders who had experience in the use of each of the instruments; (iii) undertook a meta-evaluation of OVE country program evaluations (CPEs) and corporate evaluations; and (iv) carried out particular country case studies, including a structured questionnaire for the evaluators with a section covering financial instruments, to ascertain the perceptions of clients on the usefulness of the range of instruments IDB provides.

II. OVERVIEW OF IDB'S LENDING INSTRUMENTS AND THEIR USE

2.1 OVE's evaluation of the New Lending Framework defined a lending instrument or modality as "a combination of rules and procedures applied to the development, approval and execution of lending activities."[2] There are three broad lending categories—investment loans, policy-based loans, and emergency loans—but over the years the Bank has created an array of alternative instruments within each category (see Table 1). Notably, under investment loans, by end-2011 the Bank had 11 lending instruments in place. Box 1 provides a taxonomy of IDB's lending instruments, and Annex A provides a detailed chronology of the evolution of IDB's lending instruments.

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2 The Evaluation of the New Lending Framework: 2005-2008 (RE-342-1).

2.2 IDB lending is dominated by specific investment loans (SILs) and programmatic policy-based loans (PBPs). Of the 16 different loan modalities listed in Table 1, during 2007-2011, 11 were used less than 5 times a year, compared with an average of 50 SILs and 16 PBPs a year. While 23 borrowers used SILs and 19 used PBPs, 10 of the instruments were used by 7 or fewer borrowers over the period. The least-used instrument was innovation loans, with only four operations in two countries over the five years. According to OVE's evaluation of the New Lending Framework, the proliferation of lending instruments was a way for the Bank to address the declining demand for traditional investment lending, borrowers' concerns about the high transaction costs of dealing with the Bank, and the fiscal constraints of borrowing member countries. It points out that many of the newer instruments provide a quicker preparation and approval process.

Table 1. Classification of IDB lending, 2007-2011, by instrument

	Instrument	Number	Number (%)	Original Approved Amount (US$)	Original Approved Amount (%)	IDB Countries (26) using the instrument
Lending Instruments GN-2564-3	Specific Investment Operation	253	44.7%	14,466,687,160	27.9%	26
	Global of Multiple Works Operation	38	6.7%	4,842,351,700	9.3%	15
	Multi-Phase Lending Project	40	7.1%	3,495,025,325	6.7%	14
	Global Credit Operation	16	2.8%	497,938,600	1.0%	5
	Technical Cooperation Loan	7	1.2%	36,270,000	0.07%	7
	Project Preparation & Execution Facility	18	3.2%	31,951,250	0.1%	7
	Sector Facility	11	1.9%	47,417,783	0.1%	4
	Innovation Operation	4	0.7%	40,000,000	0.1%	2
	Immediate Response Facility for Emergencies	6	1.1%	95,000,000	0.2%	6
	Performance Driven Loan	10	1.8%	709,000,000	1.4%	6
	Project Using a CCLIP (Conditional Credit Line Investment Projects)	45	8.0%	12,998,500,000	25.1%	12
Other Loans	*Hybrid Operations*	4	0.7%	265,000,000	0.5%	4
	Supplementary Financing	18	3.2%	1,567,300,000	3.0%	12
PBLS/PBP/EMEs	Policy Based Loan (PBL)	10	1.8%	1,931,800,000	3.7%	6
	Programatic Policy Base Loan (PBP)	80	14.1%	8,275,000,000	16.0%	19
	Financial Emergency Operation (EME)	6	1.1%	2,500,000,000	4.8%	5
	TOTAL	**566**	**100%**	**51,799,241,818**	**100%**	

Source: OVEDA, using the Bank's data warehouse.

Box 1. A taxonomy of IDB lending instruments and approaches

Investment loans

Specific investment loans, the Bank's first lending instrument, are used for operations that entail large, interdependent components. Each component must be fully defined and analyzed, with eligible expenditures clearly identified, before the loan is approved.

Technical cooperation loans finance consulting services and institutional strengthening activities.

Multiple works loans finance a series of small independent subprojects. Loan appraisal does not require appraising each subproject before approval by the Board; rather, it is based on appraising a representative sample of investment works to be financed by the program.

Global credit loans provide subloans to small and medium-sized enterprises through first- and second-tier financial institutions. Subloans are approved in accordance with the program's credit regulations, and proceeds of the subloans are used to finance the actual investments.

Project Preparation and Execution Facility provides advance funds for project preparation and finances continuity of project agencies for up to 4 years after completion and evaluation of project achievement.

Multiphase loans provide an overall goal and conceptual framework for phased and longer-term support of a program, encompassing more than one project cycle. Such a loan could, for example, cover a pilot phase followed by a larger investment phase.

Innovation loans finance pilot interventions or activities that are intended to take no more than 30 months to execute (dropped end-2011).

Sector facility provides fast-track support to address problems of a sectoral nature (dropped end-2011).

Performance-driven loan disburses funds against the achievement of a set of objectives specified at the outset. When the objectives are met, disbursement is made against expenditures that can be verified as having been incurred to meet the objectives (suspended in 2009, pending review).

Conditional credit line for investment projects supports development institutions with a proven track record in implementing their investment programs over the long term. Individual operations supported by the institution are subject to approval by IDB's Board.

Hybrid loans provide financial support for sector or subsector policy changes as well as funds for capital investment. They contain a fast-disbursing policy reform component and an investment component targeted to specific investments in the sector.

Supplementary financing provides additional resources required by an ongoing project to meet its objectives or to allow for expansion without change in the project description.

Policy-based loans

Policy-based loans are multitranche operations for which disbursement conditions for each tranche are specified at the beginning of the operation.

Deferred drawdown option allows countries to commit policy-based loans up front on payment of a premium, but to draw them down at a time of their choosing.

Programmatic policy-based loans constitute a series of single-tranche operations, each with its own loan contract, set in a medium-term framework of reforms/institutional changes.

Emergency loans

Immediate Response Facility for Emergencies caused by Disasters makes funds available expeditiously for immediate support in the aftermath of a natural disaster.

Contingent Credit Facility for Natural Disaster Emergencies (CCF) provides contingent funding in the event of natural disasters. Funding requires the existence of a Country Integrated Disaster Risk Management Program, and verification of occurrence of a disaster event of contractually agreed type, location, and intensity.

Contingent Credit Line for Natural Disasters (CCL) provides additional funding for emergencies. The CCF and CCL are designed to complement each other: the CCL covers a wider scope of natural disasters of magnitudes less than catastrophic, while the CCF covers a very specific type of natural disasters of catastrophic nature, in which the consequences of the disaster would necessitate a restructuring of the investment programs for that country.

Development sustainability line replaces emergency lending and is designed to protect poverty-related programs in the event of systemic or country-specific shocks.

2.3 In addition to lending instruments, IDB also offers guarantees to the public sector. The use of guarantees was foreseen in IDB's Articles of Agreement; however, until 2005 the use of guarantees was limited to the private sector. In 2004 the Board approved guidelines for local currency guarantees to public sector entities. Only two such guarantees have been made to date,[3] both designed to provide assurances to the private participants in a public-private partnership operation that the public sector will meet its contractual obligations. By providing these guarantees, IDB made it possible to attract well qualified international companies to build and operate infrastructure in Peru and Guyana. The Bank's Board has recently agreed to extend the use of the guarantee instrument to support debt restructuring in Panama.

III. FINDINGS

3.1 The steps the IDB has taken to address the IDB-9 requirements can be broken down into four separate topics: the adequacy of the range of instruments to meet borrowers' needs; steps to streamline the array of instruments and to eliminate those that are redundant; efforts to develop new instruments to meet the evolving needs of borrowers and changes in the international community's broad approach to development challenges; and the Flexible Financing Facility, which, although not itself an instrument, is an important enhancement of the financial quality of IDB lending.

A. The adequacy of the current set of instruments

3.2 IDB offers its borrowers an array of investment lending instruments that is equal to or wider than that offered by other multilateral development banks. The contrast currently is greatest with the World Bank, which in November 2012 consolidated all of its investment lending modalities into one single investment lending category expected to provide the flexibility to encompass a wide range of different approaches. By contrast, there is relatively little difference among the international financial institutions on policy loans (either the traditional tranche-based approach or the programmatic approach using triggers) and emergency/contingent lending (see Table 2). It is important to note, however, that the World Bank's recent introduction of a programmatic instrument that disburses against results (Program-for-Results)is a potentially very important departure

[3] Peru: Guarantee Program for the IIRSA Northern Amazon Hub (PE-L1010), December 22, 2005; and Guyana: Georgetown Solid Waste Management Program (GY-0055), April 11, 2006.

from the traditional division of the lending paradigm between investment and policy lending.

Table 2. Comparison of lending instruments of the multilateral development banks

Lending Instruments/Approaches	MDB Lending Instruments			
	IDB	Asian Development Bank	World Bank	African Development Bank
Investment Lending				
Specific Investment Loan	√	√	Consolidated into "Investment Loan"	√
Immediate Response Facility for Emergencies caused by Disasters	√	√		√
Technical Cooperation Loan	√	√		√
SWAp (approach)	√	√		√
Project Preparation & Execution Facility	√	√		√
Multi-phase Operation	√	√		
Global Credit Loans	√	√		
Sector Loan		√		√
Innovation Loan	(dropped)		(dropped)	
Sector Facility	(dropped)			
Multiple-Works Loans	√			
Performance-Driven Loan	(piloted 2003-2009)			
CCLIP (approach)	√			
Policy/Emergency/Contingent Lending (*)				
Policy-Based Lending	√	√	√	√
Emergency/Contingent Lending	√	√	√	√
Program-for-Results (PforR)			√	

Source: "Proposal to Reform the Bank's Sovereign Guaranteed Lending Instruments," GN-2564-3.

* *IDB:* Policy-based loan, programmatic policy-based loan, emergency lending/Liquidity Program for Growth Sustainability (2008-2009), Contingent Credit Facility for Natural Disaster Emergencies; Flexible Financing Facility, development sustainability credit line, contingent credit line for natural disasters.

World Bank: Development policy lending, special development policy lending, deferred drawdown option, catastrophic risk deferred drawdown option; financial intermediary loan, emergency recovery loan.

Asian Development Bank: Stand-alone policy-based lending, programmatic policy-based lending, special policy-based lending, Countercyclical Support Facility Lending, emergency assistance loan.

African Development Bank: Policy-based loan, Emergency Lending Facility, Trade Finance Initiative.

Note: The table does not include the loans offered by the Andean Development Corporation (CAF), which follow a somewhat different model and can be short-term (1 year), medium-term (1-5 years), and long-term (over 5 years). They finance investment programs/projects, and program loans and SWAps. Loans can be granted at all stages of project implementation. In addition to project and program loans, CAF offers governments contingent lines of credit, lines of credit, partial guarantees and sureties, financial advisory services, and technical cooperation.

3.3 Practitioners and borrowers interviewed by OVE do not see the number of investment lending instruments as a cost or a disadvantage in terms of IDB's interaction with its borrowers. The general view is that it is a good thing to have a substantial menu from which borrowers can choose[4] according to their country needs and preferences. Experience suggests that countries experiment with a new lending modality and, if the experience is positive, tend to use this modality as the primary form of interaction with IDB. This is demonstrated, for example, by the use of PBPs in Peru and Trinidad and Tobago, of the conditional credit line for investment projects (CCLIPs) in Mexico and Argentina, and of performance-driven loans (PDLs) in Chile.

3.4 A review of country experience with the use of instruments suggests a positive record overall in matching the instruments to country and sector realities. However, in a number of cases there were tensions between the expectations of the country and what the instrument could reasonably deliver. The country evaluations and staff interviews mentioned issues in connection with two instruments: PDLs and CCLIPs.

3.5 **Performance-driven loans.** The PDL was introduced on a pilot basis in 2003 as a way of reflecting the donor community's increased focus on results. The pilot program was intended to last for six years—sufficient time for some PDL loans to have completed their execution. In the third year of the program, Management would provide the Board with a progress report on its implementation; and at the end of the pilot program, Management would deliver to the Board an assessment of the PDL loans financed under the program and recommendations for future Bank action regarding the PDL instrument. The results of the assessment could be used as a basis on which to elaborate a more definite set of guidelines for the instrument.

3.6 PDLs were designed to emphasize the achievement of planned outcomes: they were disbursed once the program's results had been achieved and the Bank had verified the results and the expenses incurred by the borrower to achieve the results. The problem was that in addition to achieving outcomes, countries needed to present documentation for the contract entered into to achieve the outcomes and verification that these contracts complied with IDB procurement requirements. This double bar for achieving disbursements presented problems for some low-income countries, but even in Chile the PDLs were very slow to disburse, contrary to expectations. In the view of IDB team leaders, the PDL added limited value to investment loans: the compliance needs were the same, but much more monitoring was required (see country examples in Box 2).

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4 Even for those instruments that were recently discontinued because of lack of interest (innovation loans and sector facilities), the evaluation team interviewed staff who felt that these instruments remained of interest in the countries they worked on and should have been kept in place.

Box 2. Using PDLs: Examples from CPEs

The assumption underlying the use of a PDL was that the executing agency had the resources to undertake the project and the institutional strength and capacity to achieve the objectives. PDLs were expected to be in greatest demand when large disbursements were not required and the time lag between project approval and achievement of project outcomes would be relatively short.

Guatemala: A Mismatch of the PDL with Program Scope

At the request of the Ministry of Education, a PDL was chosen to achieve the goals of Mi Escuela Progresa—to improve coverage of preprimary schooling, access to primary schooling, and internal efficiency (repetition rates), improve learning, strengthen bilingual education, and improve education infrastructure. The demand generated by Mi Familia Progresa helped achieve some of the goals of the program relatively soon, but could not achieve all the indicators—for example, an increase of 5 percentage points in the number of tests taken in the Mayan language in which basic reading and mathematics skills are achieved. Moreover, the Ministry of Education's resources for the construction and repair of schools—equivalent to US$12 million in 2008—were insufficient to meet the estimated cost of the school infrastructure program, US$105 million.

Honduras: A Mismatch of the PDL with Country Capacity

In 2005 the Bank approved a US$16.6 million PDL for a health sector program that sought to increase institutional deliveries, prenatal and post-partum checkups, the use of family planning, and number of children vaccinated. The program's first external audit in 2007 found that virtually all the targets, even the ones set for the last two tranches, had been attained early. However, by end-2009 only about 20% had been disbursed. This PDL turned out not to be well suited to the capacity-deficient health sector. The major issue was the PDL requirement not just to deliver specified results but to account for the investments. The first tranche of the loan was disbursed in 2010, and the year closed with 50% of its proceeds disbursed. That same year the program was reformulated to complement the new US$27.5 million investment loan for the Program to Strengthen Decentralized Management and Supply of Health Services.

3.7 Given these problems, in the words of one manager in IDB, "The PDL is dead. No one will use them in the future." The last PDL was approved in November 2009 (BR-L1236, Profisco Minas Gerais), and in effect the pilot program has been allowed to lapse, pending further review and evaluation.[5] This raises some real issues for IDB in that the portfolio now lacks an instrument that disburses against results. The solution here might be to move to the approach of the World Bank, which has introduced loans that disburse against program results.

3.8 **Conditional credit line for investment projects.** The CCLIP is intended to support well-performing institutions by providing a long-term credit line that borrowers can draw on for projects, subject to agreement by IDB. It provides for an agreement without a firm commitment on either side. The CCLIP has been extremely popular with some borrowers, especially Mexico and Brazil. Among the benefits to the borrowing entities are that in countries where parliamentary approval is required for borrowing, it may be possible to secure blanket approval

[5] At the Board meeting of December 9, 2011, which reviewed and approved the "Proposal to Reform the Bank's Sovereign Guaranteed Lending Instruments" (GN-2564-2), the Board indicated that OVE should conduct an evaluation of the PDL. Because of other priorities, OVE's work program does not currently include this evaluation.

for the CCLIP and not have to go back for each individual operation.[6] In addition, there is an implicit "seal of approval" from IDB for the organization involved that may have some political value. The main saving in processing time is that once the CCLIP has been approved, subsequent operations are submitted to the Board on a "no objection" basis. The follow-up loans require fewer missions and less preparation time since the executing agency remains the same and a Project Profile is not required. However, the mechanism has some costs from IDB's perspective in that it may introduce an additional layer between IDB and the subborrower. (Box 3 provides country examples; the Mexico example is based on interviews with IDB staff, and the Brazil example is drawn from the CPE.)

Box 3. Using CCLIPS: Country Examples

Mexico: Supporting Yucatan State through a CCLIP to Banobras

According to the Mexican constitution, IDB cannot lend directly to subnationals. The Bank has worked for a long time with Banobras in the FORTEM program, with projects that were very successful in targeting subnational entities. They financed the investment plan of each subnational, provided it had appropriate budget discipline, institutional strengthening, improved fiscal and investment planning, and so on. Over time the Bank had moved to a set of indicators against which it disbursed. Initially the FORTEM program was supported through regular investment loans, and later as part of a multiphase program. With FORTEM 3 it was decided to use the CCLIP instrument, which in principle shortens transactions costs and time. IDB saw this as a means of consolidating its relationship with Banobras.

The proposal for the CCLIP was that Banobras could use it for purposes other than FORTEM and for its general investment program—the CCLIP was not limited to particular subnationals. The concept is very broad: Banobras can even finance federal agencies that are dealing with investment at the subnational level. In practice, however, there is a tension between financing Banobras's cash flow and targeting states and municipalities. In addition, Banobras focuses on infrastructure and is reluctant to cover the governance expenditures that account for much of what IDB wants to finance.

The second program of the CCLIP targets Yucatan state to provide for (i) institutional strengthening for results-oriented budgeting, strengthening the fiscal system through a semi-autonomous agency; (ii) renovation of an historic district in the capital; (iii) renovation of a pier at the port, to support tourist arrivals; and (iv) provision of statewide wireless broadband services. The results indicators are those of the Yucatan program. In the view of IDB staff, Banobras is not committed to these results, and only reluctantly engaged in the program. Now the Bank is supporting Chihuahua state for the third phase of the CCLIP, a project that has been cleared by the Secretary of Finance. The only option is to do this as a CCLIP, and IDB sees itself as locked into this umbrella project if it wants to work with State Governments in Mexico. But that means that it needs to partner with Banobras; and unfortunately, in the words of an IDB staff member, "Banobras sees IDB as a competitor rather than a partner."

Brazil: Problems with the Use of the CCLIP

Flexible and less transactional lending instruments (mainly the CCLIP), have been more beneficial for programming than for operations. The country does not see efficiency gains from the CCLIP, since each operation is independent and the concept of a line of credit is lost. This reduces the certainty of attaining the objectives for which the CCLIP was established, particularly at the federal level, and raises the uncertainty that the country can program the resources in the financial plans and targets.

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6 In Venezuela, however, it was decided not to go ahead with a CCLIP in the power sector when it became clear that by law each operation under the CCLIP would require parliamentary approval.

3.9 **Other issues regarding lending instruments.** Two other general concerns have been expressed concerning IDB instruments. First, there is a sense that some of the instruments designed to finance small programs quickly are not delivering. The innovation loans and the sector facilities are examples of this. The intention—instruments that could pilot short-duration activities at low cost—is obviously important, but since all the rules apply and these operations are subject to the same requirements for parliamentary approval as others, the transaction costs per dollar lent can become significant. One team leader reported that he had elected not to go ahead with preparing a Project Preparation Facility loan, because he felt it would be as time-consuming as preparing the eventual operation. The second concern relates to the increasing complexity of investment loans, which are being weighted down with objectives not directly related to the core investment—for example, reducing poverty of Amerindians or having an impact on climate change. Team leaders point out that in their experience the most successful investment projects are those whose core objectives are simple and direct. The need to leverage broader outcomes leads to excessively complex and ambitious projects.

B. Streamlining the array of instruments

3.10 The large number of instruments raises the question of whether all these instruments are adding value, and whether streamlining the array might encourage more focused decision-making at the country level on which instruments are appropriate for particular purposes. With this in mind, during 2011 Management undertook an analysis of the Bank's SG instruments; and in December 2011, the Board of Executive Directors approved a "Proposal to Reform the Bank's Sovereign Guaranteed Lending Instruments" (GN-2564-3). As a result, two instruments were eliminated, and two were amended.

3.11 The loans that were eliminated were innovation loans and the sector facility framework. Innovation loans, as mentioned above, were in little demand, and Management's analysis found that they provided no gains in reducing time for approval or execution. The sector facility framework had been created to implement pilot projects with shorter execution periods, but in practice the execution period tended to be of the same length as that of specific investment operations. "The streamlined approval process provides no additional value as the median project approval time has converged for all types of instruments since 2007. In addition the envisaged shorter execution period has not materialized as the average execution for loans under this instrument is above 5 years."[7] It should be noted however, that this instrument had proved quite popular in Uruguay and arguably there could have been more focus on what steps could bring down execution time. The challenge of supporting small pilot activities with timely finance is still an unsolved problem for IDB.

[7] "Proposal to Reform the Bank's Sovereign Guaranteed Lending Instruments. Second revised version," GN-2564-2.

3.12 In addition, the CCLIP and multiphase programs were amended to "ensure better alignment of individual operations with the strategic vision that is defined in the Bank's country strategies with its Borrowing Member Countries." Essentially, these instruments are made coterminous with IDB's current Country Strategy, a provision that seems to reduce one of their most attractive features—the ability to engage over a longer term with key national institutions.

C. Proposals for new instruments

3.13 PBLs were conceived as a means to provide sustained support for a program of structural or policy changes and to deliver quick-disbursing funding for budget support. In practice, a number of countries have used PBLs to secure development funding at lower transaction costs than investment loans, even if there was little need at the time for funding budget support. From IDB's perspective this was justified by the possibility of providing support for needed policy changes, often combined with technical cooperation to strengthen the capacity to implement the policy changes. The shortcomings of this use of the instrument were demonstrated during the financial crisis, when countries found that support for quick disbursement might come at the expense of other IDB support for both the public and private sectors (see Box 4).

3.14 In 2008 IDB introduced a Liquidity Program for Growth Sustainability to provide liquidity to intermediary financial institutions affected by the international financial crisis.[8] The program was intended to provide liquidity of up to US$500 million per country to "regulated financial institutions facing reduced access to foreign credit lines and interbank credit, so that they in turn can provide trade credit lines to exporters and producers for the domestic market, and maintain firms' access to working capital." The program was transitory, expiring on December 31, 2009. Loans under this program had the same terms and conditions that had been approved by the Board of Governors for the Emergency Lending Facility. The intention was that the funds for this program would come from Emergency Lending resources; therefore, there would be no opportunity cost in terms of the Bank's normal lending program for investment and policy-based loans. Between 2007 and 2011, there were six financial emergency operations, of which five were part of the Liquidity Program for Growth Sustainability. However, as Table 3 shows, three of the five were cancelled without any funds being disbursed.

[8] "Proposal for the Liquidity Program for Growth Sustainability," GN-2493-3.

Box 4. Use of Policy-based Loans: Examples from CPEs

Colombia: Issues in Delivering Quick Disbursements during the Financial Crisis

The program in Colombia used a wide variety of lending instruments to deliver support to the public sector. Relatively large programmatic PBLs accounted for 6 of the 27 projects and 40% of the amounts approved (the Bank average is 18%). The intensive use of PBLs is the result of the country's demand for unrestricted funds to meet its fiscal commitments and to stimulate the economy in the trough of the economic cycle. During the 2008-2009 global financial crisis, when Colombia faced a sharp economic slowdown, the country increased its demand for liquid resources and the Bank attempted to respond with a combination of PBPs and CCLIPs. Shortly after the Lehman Brothers bankruptcy a PBP entered the pipeline but took 21 months to be approved. Two months after Banco de la Republica drastically lowered the reference rate, three operations entered the pipeline: a CCLIP with its first associated loan, a loan under an earlier CCLIP, and a PBP. The first of these took just one month to approve, and the PBP was approved 10 months after it entered the pipeline. Thus the Bank's response to the global crisis appears to have contained elements of both expeditiousness and slowness. The Bank disbursed about US$950 million among different programmatic instruments during the five quarters of the crisis. However, the country has a negative perception of the Bank's action to address the international financial crisis. According to the Colombian authorities, the absence of clear criteria and rules for the allocation of funds during the crisis meant that the Bank's response was not as effective as it could have been. In mid-crisis, the scarcity of its funding meant that operations in the public and private sector competed with each other. It became necessary to cancel approval of non-sovereign-guaranteed operations in the pipeline, which increased dissatisfaction among government authorities.

Uruguay: The Need for a Contingent PBL

Three PBLs/PBPs were designed to help put through specific reforms approved by the country, though in practice two of the operations were executed as contingent liquidity facilities. The government held off for about a year on requesting disbursement of the proceeds approved for the proposed competitiveness program and the second tranche of the social sector PBL, even though all the conditions in each loan's policy matrix had been fulfilled. No disbursement request was made for either loan because, according to the operations' Project Performance Monitoring Report (PPMR), the funds were not needed. The loans ultimately disbursed in December 2008 (in the wake of the global financial crisis). In practice, then, these loans were used as contingent liquidity facilities. This use of quick-disbursing loans was not in line with the previous CPE's recommendations to establish financing relations with executing agencies on the basis of periodic accountability and results-based performance.

Table 3. Commitments and Disbursements under the Liquidity Program for Growth Sustainability

Operation Number	Operation Name	Country Benefits	Approval	Original Approved Amount	Operation Status (June 30, 2012)	Disbursed Amount (June 30, 2012)
CR-L1033	Liquidity Program for Growth Sustainability in Costa Rica	Costa Rica	12/17/2008	500,000,000	CANCELLED	-
DR-L1040	Liquidity Program for Growth Sustainability	Dominican Republic	3/20/2009	300,000,000	CANCELLED	-
ES-L1029	Liquidity Program for Growth Sustainability	El Salvador	12/17/2008	400,000,000	COMPLETED	186,439,263
JA-L1023	Liquidity Program for Growth Sustainability	Jamaica	1/14/2009	300,000,000	COMPLETED	98,152,178
PN-L1048	Liquidity Program for Growth Sustainability	Panama	4/15/2009	500,000,000	CANCELLED	-

3.15 The Bank's Governors recently approved a proposal by Management to establish contingent lending instruments[9] to increase the flexibility of the Bank's overall lending instruments to mitigate shocks and "enhance the countercyclical capacity of the Bank to address future needs of this kind in the Region." Two new lending instruments have thus been added:

- The Development Sustainability Credit Line (DSL) replaces the emergency lending category and is focused on either systemic or country-specific shocks. It is designed to protect poverty-related programs in case there is, for example, a sharp terms-of-trade shock. US$2 billion is available for the credit line, with a ceiling of US$300 million per country or 2% of GDP, whichever is lower.
- The Contingent Credit Line for Natural Disasters (CCL) complements the Contingent Credit Facility for Natural Disasters and provides additional resources in the event of natural disasters.[10] Again, US$2 billion is available, but the ceiling is US$100 million per country, or 1% of GDP, whichever is lower.

3.16 In addition, the Board authorized the use of the deferred drawdown option for regular policy-based operations to allow countries to approve their allocation of PBLs in a given year but have access to the resources in amounts, and at the time, that meets their needs most effectively.

D. The Flexible Financing Facility (FFF)

3.17 On January 1, 2012, the new Flexible Financing Facility (FFF) (FN-655-1) became fully operational, replacing the existing platform for approval of SG loans financed with funds from the Bank's ordinary capital. The FFF enables borrowing countries to tailor loan terms and conditions to suit their individual needs, as well as to use hedges for interest rates and currency risk management, subject to market availability.[11] While the FFF is not an instrument, it is a way of adapting all IDB lending to meet the borrowers' needs, and thus it is consistent with the directives of IDB-9. The availability of the FFF has been explicitly mentioned by IDB borrowers (e.g., Colombia) as important evidence of the institution's responsiveness to borrowers' concerns.

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9 Proposal to Establish Contingent Lending Instruments of the IDB, approved October 4, 2012.

10 "Both instruments for natural disasters are designed to complement each other. The CCL is designed to cover a wider scope of natural disasters of magnitudes less than catastrophic. The CCF covers a very specific type of natural disasters of catastrophic nature, in which the consequences of the disaster would necessitate a restructuring of the investment programs for that country. A review of both of these instruments will be carried out at the end of 2015." "Proposal to Establish Contingent Lending Instruments of the IDB."

11 "Progress Report on Implementation of the Agenda for a Better Bank" (GN2518-43), May 3, 2012, p.7

E. Conclusions

3.18 IDB offers a wide range of instruments to its borrowers—indeed, as many as or more than other international financing institutions. What is particularly striking is the distribution among borrowers of the use of these instruments. Particular borrowers seem to find that particular instruments meet their needs, and they then make substantial use of these instruments in their program.

3.19 In general, IDB seems on track toward meeting the IDB-9 requirements in the area of lending instruments. The Bank has taken four significant steps since IDB-9: a careful review of all lending instruments; the elimination of two instruments (innovation loans and sector facilities); the introduction of two new contingent instruments and the deferred drawdown option for policy-based lending[12]; and the launching of the FFF.

3.20 The key gap in IDB's range of instruments appears to be the absence of a viable instrument linking disbursements to the achievement of results. The PDL was undercut by linking disbursements not merely to results and outcomes, but also to the specific eligible expenditures incurred for the achievement of those results. IDB should consider establishing a working group to review other MDB's experience with lending for results, including the World Bank's experience with the introduction of Program-for-Results lending. With the increasing donor emphasis on results and the growing sophistication of IDB's large middle-income borrowers, it is likely that an instrument along these lines will attract considerable interest in the future.

IV. SUGGESTIONS GOING FORWARD

4.1 Clients appreciate the wide range of instruments offered by IDB, and they welcome the recent introduction of flexible financing. The decision to eliminate the innovation loans and especially the sector facility is helpful in simplifying the overall structure of lending instruments. The Bank has recently moved to fill one significant gap—the absence of a contingent instrument. OVE has the following suggestions to Management to further the full and effective implementation of the IDB-9 requirements.

- There have been design problems with performance-based instruments such as the PDL, and as a consequence there was limited uptake of these instruments. IDB could usefully put an instrument on its books that provides for disbursement linked to the achievement of results, as, given the increasing focus on results, this is clearly the logical direction for MDB lending over time. As in the World Bank's approach, the use of such an instrument could be limited to programs in which IDB can validate ex ante that procurement,

12 The Bank could have moved more quickly to fill the gap in the availability of contingent instruments. The World Bank has had a contingent instrument in place for a decade or more. This step could have been taken even without a reduction in the capital buffer.

financial management, and safeguards for the program as a whole meet IDB requirements, but without requiring ex post validation of eligible expenditures.

- The CCLIP has had a mixed record. It appears to be popular with some borrowers, but perhaps this reflects the sense that IDB is acknowledging the record and maturity of the implementing institution, rather than its role in reducing the transaction costs of borrowing. The requirement that each loan be separately appraised and processed undercuts the intention of providing guaranteed financing more expeditiously. IDB needs to review this instrument carefully to see how best to optimize its innovative design.
- The evidence suggests that beyond the basic instruments (investment, policy-based, and emergency), the real issue is not the availability of instruments but the transaction costs of borrowing from IDB. The key is reducing those transaction costs while maintaining the incentive for funds to be used efficiently and for the purposes for which they are given. On this IDB's recent record is quite good, with substantial reductions in processing times; but there is still some way to go, and this is an area that IDB needs to keep under review.

4.2 This discussion has not dealt much with the issue of support for innovation. The reason for this is that innovation is not seen as an instrument issue per se: innovation can be supported through any instrument. The issue is whether IDB is able to support small, pilot, and innovative programs in a timely, low-cost fashion. By and large, for SG operations the primary mechanisms for support of innovation are the technical cooperation programs, which are discussed in the background paper on IDB's Knowledge Products.

LIST OF PERSONS INTERVIEWED

Name	*Title*	*Department*
Alejandro Melandri	Energy Lead Specialist	INE/INE
Silvia Raw	Sector Lead Specialist	OVE/OVE
Tracy Betts	Division Chief, Strategy Monitoring	SPD/SMO
Carlos Pineda	Urban & Mun. Development Lead Specialist	IFD/FMM
Morgan Doyle	Sector Sr Advisor	VPS/VPS
Sikander Daryanani	Unit Chief, Fin Pol & Dec Sup	FIN/FPD
Hector Rabade	Fiduc. Fin. Mgmt. Lead Specialist	VPC/FMP
Felix Prieto	Fiduc. Procurement Principal Specialist	VPC/FMP
Nestor Roa	Div. Chief, Transport	INE/TSP
Carola Alvarez	Div. Chief	SPD/SDV
Susana Sitja	Sector Principal Specialist	SPD/OPT
Fidel Jaramillo	Country Rep. Peru	CAN/CPE
Omar Zambrano	Country Economist Peru	CAN/CPE
Rodrigo Parot	Country Rep. El Salvador	CID/CES
Michelle Cross	Country Rep. Trinidad and Tobago	CCB/CTT
Sophie Makonnen	Country Rep. Guyana	CCB/CGY
Tomas Bermudez	Country Rep. Panama	CID/CPN
Mario Cuevas	Country Economist Panama	CID/CPN
Rafael de la Cruz	Country Rep. Colombia	CAN/CCO
Francesca Castellani	Country Economist Colombia	CAN/CCO
Rocio Medina-Bolivar	Country Rep. Venezuela	CAN/CVE
Reinier Schliesser	Country Economist Venezuela	CAN/CVE
Juan Jose Taccone	Country Rep. Uruguay	CSC/CUR
Alejandro Rastelleti	Country Economist Uruguay	CSC/CUR
Maria Camila Uribe	Country Rep. Chile	CSC/CCH
Bernardita Piedrabuena	Country Economist Chile	CSC/CCH
Daniela Carrera	Country Rep. Brazil	CSC/CBR
Fabiano Bastos	Country Economist Brazil	CSC/CBR
Hugo Florez Timoran	Country Rep. Argentina	CSC/CAR

Name	*Title*	*Department*
Gabriel Sanchez	Country Economist Argentina	CSC/CAR
78 Operational IDB Field Staff Members in 12 Countries (Argentina, Brazil, Chile, Colombia, El Salvador, Guyana, Mexico, Panama, Peru, Trinidad and Tobago, Uruguay, and Venezuela)		
138 Government Officials in Finance and Line Ministries in 12 Countries		

ANNEX A. A CHRONOLOGY OF LENDING INSTRUMENTS REFORMS

1959: IDB is established, with **specific investment loans** as the sole lending instrument.

Prior to 1978 three additional investment loan instruments are introduced; **Multiple Works Loans**; **Global Credit Loans** and **Technical Cooperation Loans**.

In 1989 **Multi-tranche Policy-based loans** are introduced, along with Hybrid loans that allow a mix of Policy-based and Investment lending.

In 1998 the Board approves the creation of the **Immediate Response Facility for Emergencies caused by Disasters**. During the Asian crisis in 1998-1999 the Bank establishes a temporary emergency lending facility.

After 1998, the Bank experiences a sharp decline in demand for investment lending. To address client perceptions that investment lending instruments are rigid and cumbersome and generate high transaction costs in March 2000 the Board approves the Proposal for New Flexible Lending Instruments (FLIs) (GN2085-2) including the following products: **Innovation Loans (ILs), Multi-phase Loans (MPLs), Sector Facilities (SFs), and the Project Preparation and Execution Facility (PROPEF).** A 2002 assessment concludes that the FLIs have enriched the menu of the Bank's lending contributing to its ability to respond to borrowers' needs in a timely fashion.

An Operational Assessment is presented to the Board in April 2007 of these instruments. (GN-2085-15):

Innovation Loans: The main purpose of the Innovation Loan is to provide a flexible instrument through which pilot interventions or activities can be financed. 27 of these loans were approved between 2000 and 2006 with an average size of $6.7m. In practice they fell into two categories: Information and communications innovation mainly focusing on technological products; and Capacity building and institutional innovations. The expectation was that these loans would be completed in 30 months. However the complex bidding process for contracting services meant that the average execution period was 56 months. A survey carried out of IDB staff raised concerns about the limited flexibility built into these loans and the demand they placed on staff time and expertise due to their pilot nature. It appeared from the survey responses that this was seen as a small loan instrument for expedited approvals, and not as a learning instrument. Only 3 of the 27 loans provided the foundation for larger scale programs. After 2003 demand for these loans fell substantially with project teams favoring the multi-phase loan instrument.

Multi-phase Loans: The main purpose of the Multi-phase Loan is to provide an overall goal and conceptual framework for phased and longer-term support of a program, encompassing more than one project cycle. 52 of these loans were approved between 2000 and 2006 with an average size of $117m., and a total of $6.085b. The essence of these loans is that they allow for simplified approval of the second phase. They are concentrated in the social sectors accounting for 76% of the total. These loans are classified into three types: a) *Traditional* – the first phase focuses on institutional strengthening and initial disbursement and the second phase continues the investment program prepared in phase 1. This is used mainly for infrastructure projects. Second is the *institutional* Multi-phase offering capacity building investment or services to specific institutions within each Phase of the project and encouraging decentralization and participation of key beneficiary groups. This has been particularly useful for rural poverty programs. Third is the innovative Multi-phase including a first phase of intensive pilot activities, and a second Phase that builds on the successful activities. IDB staff rated the Multi-phase Loans 'extremely successful' in achieving the objectives of flexible lending operations. They were viewed as being flexible in processing, open to new development approaches, enhancing capacity building partnerships, more rapid response, and greater efficiency in implementation.

Sector Facility: The purpose of the Sector Facility is to provide fast track support to address problems of a sectoral nature. Three sector facilities were approved under the framework; for education, health and trade. Subsequently, facilities were approved for Disaster Prevention, Institutional Development, and Transnational Infrastructure. The facility was set up with a total amount of $150m. and a ceiling of $5m. on any individual project The overall size limit was exceeded in 2005 and the limit was relaxed in 2006 to allow new projects to be processed. While the loans seem to have been in demand for developing institutional capacity of an executing agency prior to the authorization of a large investment loan, the problem encountered has been the slowness of project execution. The processing time is essentially the same as for regular investment loans. Although commitments were $182 million in 2006 only 17 percent had been disbursed.

Project Preparation and Execution Facilities (PROPEF): The main purpose of the PROPEF is to strengthen project preparation and extend support to encompass start-up execution activities, often covering gaps between project preparation and start-up. Up to $1.5 m. can be committed prior to a Project Concept Document and up to $5 m. afterwards. During 2000-2006 77 PROPEF operations were approved for an amount of $40.4m. Turnaround is fast with time to first disbursement of 3.5 months and total execution period of 24.5 months. 12% of all operations have PROPEF financing.

At the 2001 Annual Meeting, Governors request that further steps be taken to make investment lending more results oriented and programmatic. Consequently the PDLs, CCLIP and SWAps are introduced in the following years (see below).

In March 2002 the Board of governors approves the establishment of the Emergency Lending Category 2 with a revolving aggregate amount of up to $6b. of Ordinary Capital resources.

In 2003 **Performance-Driven Loans**, which disburse against outcome achievement, are introduced, along with a new programmatic approach for investment lending – the **Conditional Credit Line for Investment Projects (CCLIP)**. These approaches provide a faster track to loan approval.

In 2004 **SWAPs (Sector Wide Approaches – Programmatic approach**) are approved to enable IDB to participate in these operations alongside other donors.

In 2004 there is a major change in Bank operational procedures with the new policies on expenditure eligibility and cost overruns. The new policy allows for the financing of any expenditure required to achieve the project's development objectives, subject to certain conditions. In addition the Borrower can now choose the share of Bank financing and local counterpart. Adjustment to the supplementary policy broadens the use of this financing to all investment lending instruments, rather than restricting it to specific investment loans.

In 2005 the **programmatic Policy-based Loan** is introduced to provide flexibility to adjust policy conditions to changing circumstances.

In March 2006 the Board approves an increase in the cumulative limit of $150m., for the Sector Facility, and requests Management to prepare an evaluation of all the Flexible Instruments approved in 2000.

In February 2007 the Bank approves the Disaster Risk Management Policy to improve borrowing member countries' financial management and planning practices for natural disasters. A key recommendation of this is the need for Bank-designed ex-ante risk financing instruments. The first instrument thus developed was the Contingent Credit Facility (CCF) for Natural Disaster Emergencies approved in February 2009.

In 2007 a new project cycle is implemented, shifting the emphasis from approval to implementation by giving project teams the flexibility to determine the degree of ex ante project preparation based on the particular risks of the project. The approval process is also streamlined to increase the agility and speed of project approval. Many of the procedural obstacles to approval that have given rise to specialized instruments with unique approval processes are eliminated. These changes lower the median processing time for projects to advance from profile to approval, from 406 days in 2005 to 184 days in 2010.

In April 2007 the Operational Assessment of the flexible lending instruments is presented to the Board. It presents a mixed picture. The innovation loans have provided a focus on innovation that is important, but there needs to be increased flexibility in execution and the 30 month execution limit needs to be raised. The Multi-phase Loans have 'transformed the nature and scope of Bank lending from the traditional investment projects to multi-sectoral and integrated development programs.' The Sector Facility Framework is particularly problematic and new procedures are needed to enhance disbursements. PROPEF is recognized as an important instrument in pipeline and project start-up development. Two resolutions propose changes in the operating rules for Innovation Loans and the Sector Facilities.

In 2008 the Liquidity Program for Growth Sustainability is established on a temporary basis within the Emergency Lending category with the objective of maintaining the flow of credit to the real economy. It expired on December 31st, 2009.

In February 2009, the Board approves the Contingent Credit Facility for Natural Disaster Emergencies. This is envisaged as a temporary solution to meet client demands with a maximum overall size of $600 m. and a per-country limit of $100 m.

In August 2009 the Board of Governors approves a reduction in the amount available for the Emergency Lending category to $3 b. in order to increase the amount of resources available for investment and policy-based lending operations. The Board also requests Management to prepare a review of the utilization of the Emergency Lending category and to propose recommendations regarding the future of the category.

In November 2009 Management proposes to the Board that a review of lending instruments for SG operations be undertaken, given the changing global context. In April 2010 Management submits to the board "A Proposal to Reform the Bank's Sovereign Guaranteed Lending Instruments." The Board approves this in December 2011. The Proposal is that six investment lending instruments should remain, but that two will be eliminated: **Innovation Loans** and **the Sector Facility Framework and Individual Facilities** on the grounds of low demand and limited value added. The first had been created to reduce approval times and the second to implement pilots with shorter execution periods, but in practice neither have achieved these goals. In addition it is proposed that the **CCLIP** which had been introduced as a pilot program for six years should continue. The CCLIP along with the **Multi-Phase Programs** are amended to ensure better alignment of individual operations with the Bank's country strategies. It is also proposed to retain the **SWAps** despite low levels of demand, but with clearer guidelines on use. The review does not cover the Emergency lending category given the ongoing work on developing Contingent Lending Instruments in that area.

In 2009 the pilot period for the Performance Driven Loan (PDL) is completed and allowed to lapse. In 2010 it is suggested that it be evaluated by OVE. Given other priorities, in 2011 OVE and the Board agree, as part of OVE's annual work program and budget discussion, to remove it from OVE's 2012 work program.

In April 2011 the Flexible Financing Facility (FFF) is approved, providing clients with access to a wide array of market-based financial products.

In July 2012 IDBs Board approve a *Proposal to Establish Contingent Lending Instruments of the IDB.* This establishes a set of contingent instruments. Funds for this purpose will be drawn from the Unused Borrowing Capacity (UBC) buffer. In the past the Bank has operated with a buffer of $4 b., but given new capital subscriptions under GCI-9, the buffer can be prudently reduced to $2 b. and the additional lending capacity created can best be used for a contingent lending facility, since if used to boost aggregate IDB lending it would only add $200 m. a year. Two new contingent lending instruments are approved. The first is the **Development Sustainability Credit Line (DSL)** which replaces Emergency Lending. Under the DSL individual operations will be approved by the Board prior to the onset of an economic shock and then drawn down if the shock materializes on the basis of a set of agreed criteria. A maximum limit of $300m, or 2% of GDP, whichever is less, is proposed. The focus of the DSL is to protect social programs or capital investment in the event of an economic shock. The second instrument is the **Contingent Credit Line for Natural Disasters (CCL)** to provide borrowing member countries with resources to cover urgent financing needs that arise immediately after a natural disaster. The country limit for these would be $100 m. or 1% of GDP, whichever is less. In addition the Board approved a deferred draw down option which allows countries, on payment of an upfront premium, to draw on the resources of policy based loans, as and when they require these funds.

Management Comments

Mid-Term Evaluation of IDB-9 Commitments
Background Paper: Lending Instruments
Management Response

I. INTRODUCTION

1.1 Management welcomes this background paper and thanks OVE for the constructive dialogue with Management and staff during its preparation. This evaluation will contribute to the Bank's efforts to more properly align its financial instruments with client needs, as mandated under the Ninth General Capital Increase in Resources (IDB-9).

1.2 Management provided detailed comments to OVE on an earlier draft of this document and is pleased to see that some of its suggestions were incorporated in this final version.

II. OVERALL FINDINGS AND SUGGESTIONS

2.1 The background paper provides good insights into the Bank's implementation of the IDB-9 requirements regarding operational instruments that called for a review of lending instruments and their streamlining.

2.2 Management shares OVE's finding that the Bank has taken "significant steps" since IDB-9, namely: i) a careful review of all lending instruments; ii) the elimination of two instruments (innovation loans and sector facilities); iii) the introduction of two new contingent lending instruments along with the Deferred Draw-down Option (DDO) for policy-based lending (PBLs); and iv) the launching of the Flexible Financing Facility. Likewise, Management agrees with the evaluation's conclusion that the performance driven loan (PDL) was not considered useful by Borrowers because it linked disbursements to both achievement of results and eligible expenditures. Management is also pleased to see OVE's acknowledgement of clients' appreciation of the wide range of instruments offered by the Bank

III. LOOKING FORWARD

3.1 As indicated in the background paper, the Bank's efforts at reducing the transaction costs of borrowing have resulted in substantial reductions in processing times. Management's continued efforts at further reducing transaction costs are consistent with OVE's suggestions to work in this area.

3.2 With respect to the suggestion for the Bank to have an instrument that disburses against results, Management fully agrees and believes that the PDL could be redesigned to make it more attractive to Borrowers by focusing its disbursements solely on the achievement of results.

3.3 Management looks forward to working with the Board on further consideration of OVE's suggestions regarding the requirement that every loan under the Conditional Credit Line for Investment Projects (CCLIP) be separately appraised and processed. However, we would like to clarify that although the intent of the CCLIP was to provide more expeditious financing for Borrowers with solid track records, financing under this instrument is not "guaranteed" as the background paper states. The CCLIP policy (GN-2246-1) specifies that, "approval of a line of credit does not require the commitment of the lending authority resources of the Bank….the Bank only commits resources when the Board of Executive Directors approves the individual operations [under the CCLIP]."