RE-342-1

THE EVALUATION OF THE NEW LENDING FRAMEWORK, 2005-2008

Office of Evaluation and Oversight*, *OVE

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Table of Contents

Introduction

This document presents an independent evaluation of the implementation of the New Lending Framework (NLF) covering the period 2005-2008. This review was called for by Governors in Recommendation 11 of the NLF document, which directed that a document be prepared *"…for consideration by the Board of Executive Directors prior to the completion of the Lending Framework period and ahead of any vote by the Governors on a subsequent lending framework for the period beginning 2009*."

At the request of the Board of Executive Directors, this evaluation is structured around the following 10 basic recommendations made to Management in the NLF document:

Recommendation 1: *Maintain the three lending categories*

Recommendation 2*:* *Establish flexible OC annual lending levels within a fixed total volume of lending per category over the 2005-2008 period*

Recommendation 3: *Continue to finance policy-based loans out of FSO resources for FSO-eligible countries*

Recommendation 4: *Make investment loans more flexible*

Recommendation 5: *Continue to provide emergency loans.*

Recommendation 6: *Strengthen country programming to enhance country focus*

Recommendation 7: *Adopt a programmatic approach*

Recommendation 8: *Continue improving the development effectiveness of Bank programs and projects*

Recommendation 9: *Strengthen IDB Non-Financial Products and Technical Assistance*

Recommendation 10: *Strengthen analytical capacity*

Because there are a number of common themes that emerged during the evaluation, the 10 specific recommendations are grouped into 5 thematic chapters, each containing one or more of the 10 specific recommendations.

Chapter 1 deals with quantitative limits on lending approvals as called for in recommendations 1 and 2 of the NLF. Although Recommendation 5 on emergency lending also deals with lending limits, there were no emergency loans made during the NLF period, and so the discussion of this recommendation is provided in Chapter 5 which considers the development effectiveness of various instruments.

Chapter 2 addresses the question of how Bank activities are programmed with the borrowing member countries, and focuses primarily on Recommendation 6 to "*strengthen country programming to enhance country focus*."

Chapter 3 deals with Bank instruments, and covers Recommendation 4 relating to the flexibility of investment loans, and Recommendation 7 relating to the adoption of a programmatic approach in the use of Bank instruments, and Recommendation 3 relating to the continued use of policy-based lending in FSO countries.

Chapter 4 discusses the implementation of recommendations dealing with the mobilization of knowledge and analysis in support of the Region's development processes. It addresses Recommendation 9 (strengthen non-financial products and technical cooperation) and Recommendation 10 (strengthen analytical capacity).

Chapter 5 looks at the broad question of enhancing the development effectiveness of the Bank. It focuses primarily on Recommendation 8 (improve development effectiveness), but also devotes particular attention to the development effectiveness of emergency lending operations included in Recommendation 5.

Chapter 6 steps back from the specific recommendations made in the past NLF agreement and provides a broader evaluative discussion on the role which lending frameworks play in orienting the work of the Bank.

Each chapter has a similar narrative structure. Individual NLF recommendations are presented accompanied by an analysis of the specific supporting language in the NLF agreement and related documents. Quotations from documents are presented in italics. This kind of textual analysis is required because the recommendations themselves are often couched in very general terms which make it hard to determine original intent with an adequate degree of precision and specificity. This is followed by a presentation of data relating to the implementation of the recommendation and the consequences of implementation for both the Bank and the Region. Data is drawn both from Bank documents and from specific evaluations conducted by OVE during the NLF period. Each chapter concludes with a small number of recommendations relating to the theme of that chapter.

The 10 NLF recommendations covered a very wide spectrum of Bank activity, and most were constructed rather vague and subjective terms, ("strengthen", "continue to", "improve", "enhance"). Few contain any specification of what kinds of data would establish whether the recommendation had been fulfilled. As a result, the evaluation has needed to develop operational definitions of many of the recommendations, and provide a broad range of data that could possibly measure the achievement of intended results.

As a result, this evaluation is substantially longer than usual: in fact, each chapter is approximately the same length as a standard OVE evaluation report. However, each chapter is largely self-contained. While the chapters sum to an overview of the entire NLF agreement, each stands alone and could be considered separately by the Board in the process of developing the next lending framework agreement.

I. LENDING LIMITS

1.1 This chapter deals with the approvals limits on specific types of lending, and relates specifically to NLF Recommendation 2, which stated:

> *Establish flexible OC annual lending levels within a fixed total volume of lending per category over the 2005-2008 period and eliminate minimum disbursement periods. The Board of Governors would authorize new SLLs for investment loans, PBLs and emergency loans during any consecutive four-year period, the first of which shall begin on January 1, 2005 and end on December 31, 2008, after adjusting the existing SLLs by new terms and conditions, current financial information, and consistent with the Bank's capital adequacy policy and lending authority, as well as with the Bank's Charter. Furthermore, the Board of Governors would approve the overall limit for the amount of OC PBL disbursements allowable during the 4-year periods. ….Limits on minimum disbursement periods of the lending categories would be eliminated.*

1.2 Investment loans and PBLs were thus subject to limits on approvals over the four year period, while emergency lending was subject to a permanent limit on outstanding balances. These limits were a modification of similar constraints established in the prior NLF agreement, covering the period 2002-2004, but they also reflect a long history in the Bank regarding restraints on all or part of the Bank's lending program.

A. Origins of lending limits

1.3 At its inception, the Bank was capitalized by the shareholders with both paid in and callable capital. This capital base supported the Bank's own borrowing, and the combination of capital and borrowing supported lending to borrowing member countries. The Agreement Establishing the Inter-American Development Bank (Charter), defined an overall limit on lending capacity in the following terms:

> *The total amount outstanding of loans and guarantees made by the Bank in its ordinary operations shall not at any time exceed the total amount of the unimpaired subscribed ordinary capital of the Bank, plus the unimpaired reserves and surplus included in the ordinary capital resources of the Bank.*

1.4 Because most of the Bank's capital was in callable form, it was necessary for the Bank to borrow funds in order to support its lending program. As a new entity with no track record, it was difficult for the markets to establish a risk rating Bank bonds. In order to secure a high credit rating, the new Bank established a borrowings policy which initially was embedded as a covenant in the Bank's bonds. The first US bond prospectus in 1962 expressed the covenant in these terms:

> *So long as any of the Bonds shall be outstanding, the Bank will not borrow funds for inclusion in its ordinary capital resources or make guarantees chargeable to such resources if the amount so to be borrowed or the amount so to be guaranteed, when added to the aggregate amount then outstanding of such borrowings plus the amount then outstanding so guaranteed would exceed the*

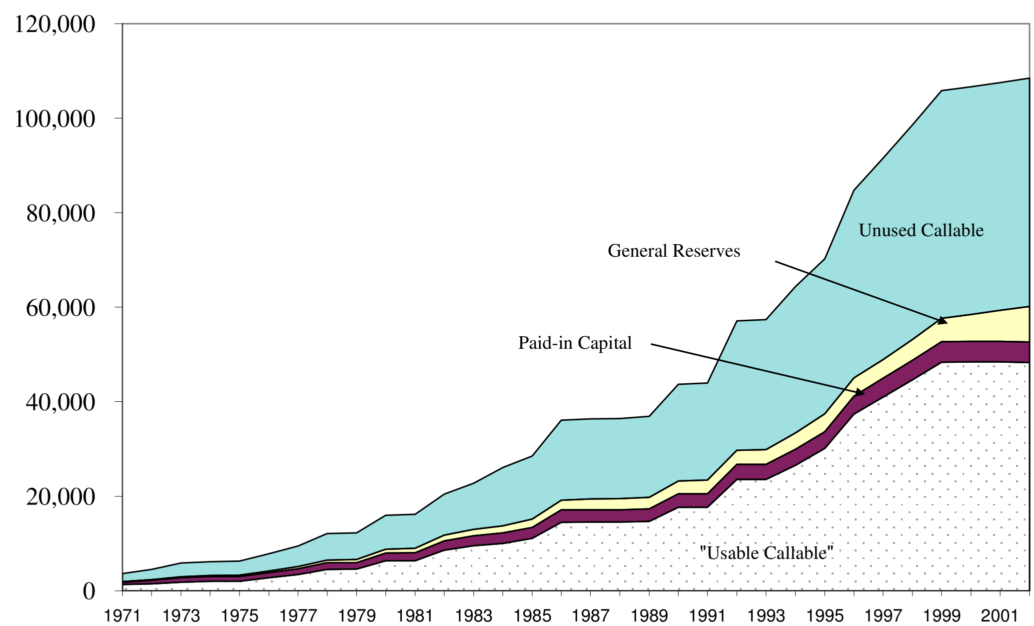
amount of the subscription of the United States of America to the Banks callable shares."[1]

1.5 These provisions effectively transferred the triple-A credit rating of the US to the Bank, and thus allowed a similar rating for this initial bond. Over time, this language was modified to include the callable capital of all non-borrowing member countries, and was removed from the individual bond prospectuses and included as a statement of policy in the Bank's Information Statement that accompanied each bond issue. Since the US and other non-borrowing countries accounted for roughly half of the Bank's callable capital, this borrowing limit established a new effective lending limit for the Bank that was roughly half that defined in the charter.

1.6 As the Bank approved operations, outstanding loan balances began to approach the policy-derived lending limit, and as this happened, Governors would periodically approve increases to the Bank's subscribed capital. Figure 1.1 shows the historical growth of the basic components of Bank lending authority. "Usable" callable capital refers to the callable provided by the U.S. and other non borrowing shareholders. Together with paid-in capital and the General Reserve, these items constitute the Bank's lending authority as defined by the borrowings policy. Adding the "unused" callable capital of borrowing shareholders gives total lending authority as defined by the Charter.

Figure 1.1

Components of Lending Authority

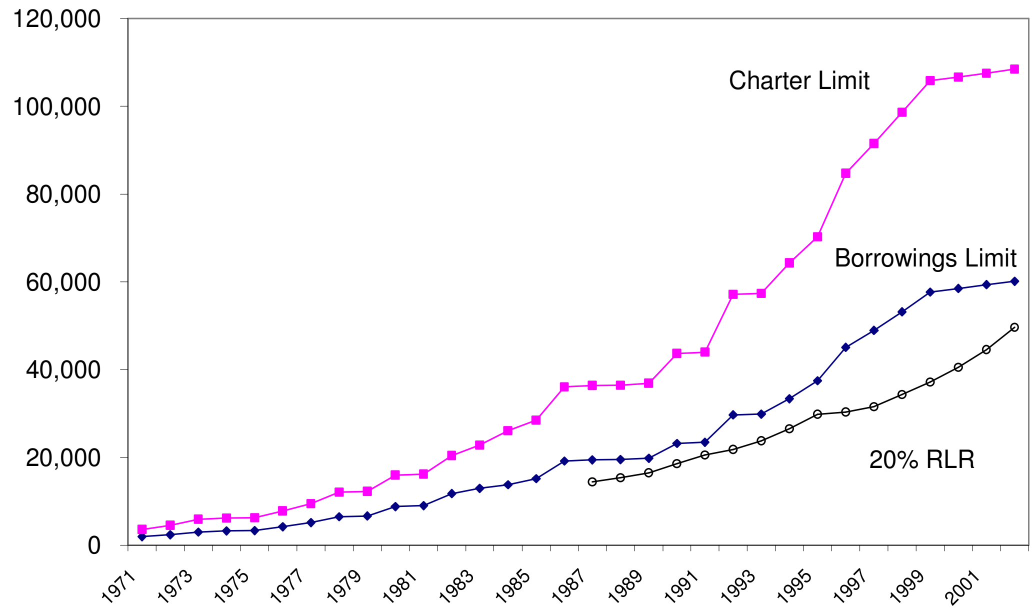


1.7 These limits were related to the Bank's overall capitalization, most of which was in the form of callable shares. Since a call on the capital would be a major

[1] Prospectus, Inter American Development Bank $75,000,000 twenty year bonds of 1962, December 11, 1962.

disrupting event, Management also adopted policies related to the desired level of reserves, which were a form of capital readily available for use by the Bank. Policy focused on the "Reserves to Loans Ratio" (RLR), and since 1989 aimed to keep reserves in a range between 20 and 25% of the OLB. The RLR target was an administrative number, not based on an actual analysis of the risks the Bank might need to cover.[2] The lower limit of the RLR policy was thus, in effect, another limit on the Bank's ability to lend. Figure 1.2 shows the three lending constraints in effect until 2002.

Figure 1.2
Lending Limits



1.8 Each replenishment agreement added to capital and thus to lending authority, and most were of a size to support an anticipated 4-5 year program of loan approvals before exhausting lending authority. With the Fifth Replenishment, Governors began to use replenishment agreements as a way to establish specific substantive performance objectives for the Bank's lending program. Targets were set for lending by sector, by country group, and for lending directed at poverty reduction and social equity. These goals were seen as "indicative" targets, not rigid prescriptive limits, but they required periodic reporting by Management on these objectives as part of the process of negotiating subsequent replenishment agreements.

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[2] Management explained the logic in these terms "Historically, the RLR has been roughly equal to, or slightly larger than, the OLB of the Bank's largest borrower. As such, it is the largest single component of the Bank's risk-bearing capacity that would be used prior to erosion of the Bank's paid-in capital should a borrower(s) go into default. The Bank's current policy of operating within an RLR range of 20%-25% was recommended and approved in Document FN-415 in late 1989". GN-2031-1 "Proposal for action by the Inter-American Development Bank to mitigate the impact of the global financial crisis on Latin America and the Caribbean."

1.9 The Seventh Replenishment defined a four-year lending program (1990-1993) of approvals not to exceed $22.5 billion, and retained the old indicative targets for lending by country group and for poverty reduction and social equity. It also introduced a new type of lending – sector loans – that disbursed rapidly in support of policy reform rather than the financing of specific investment projects. These loans were controversial, and were initially required to be done only in partnership with the World Bank. In addition, the IDB-7 agreement limited the use of this instrument to 25% of the anticipated 1990-1993 lending program of $22.5 billion. In 1992, Governors authorized expanded use of this instrument to support debt and debt service reduction, with the result that sector/policy based lending eventually accounted for 27% of actual loan approvals during the period.

1.10 In 1992, discussions began on an Eighth Replenishment of Bank resources. Management submitted to the Committee of the Board of Governors a draft chapter for the anticipated IDB-8 document that laid out two different approaches to managing the Bank's lending program, deemed the "traditional" approach and an approach based on a calculated Sustainable Level of Lending (SLL).

> *the "traditional" approach assumes: i) a desired four year lending program that grows at a specific yearly percent; and ii) the need for a new replenishment after the four year period of the replenishment is over.*
>
> *The SLL approach, on the other hand, assumes a given lending level that is maintained into the future without a specific requirement of a new replenishment.*[3] .

1.11 As the negotiations progressed, Governors elected to make neither choice presented by Management. A large capital increase of $40 billion was adopted, but with no four-year lending program connected to future replenishment negotiations (thus no "traditional" approach), and the term "Sustainable Level of Lending" was not mentioned anywhere in the final agreement. In effect, the IDB-8 agreement created an open-ended lending program in which financial limits did not define the path of future approvals. Instead, the IDB-8 agreement intended that:

> *Actual lending in any given year will vary depending on the borrowers' needs and capacities, the state of the Bank's project pipeline, and the Bank's capacity to prepare good projects.*

1.12 Within this open-ended lending program, the Agreement did continue with the past practice of constraining specific types of lending. Concluding that the need for major macroeconomic adjustment support had declined, the Agreement reduced the prior cap on policy based lending from 25% to 15% of the lending program. The Agreement also authorized the Bank to develop a limited program of lending to the private sector without government guarantee. Such loans were limited to 5% of "commitments corresponding to the Eighth Replenishment lending program," which was interpreted to mean the total new approvals.

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[3] CA-341-1 "Report on the Eighth General Increase in the Resources of the Inter-American Development Bank. Chapters I, II, and III" paragraph 3.22

1.13 These lending limits were challenged by the rapid deterioration of capital markets in 1997-98, when the Asian financial crisis effectively closed capital markets to many of the Bank's borrowing members. Although no comprehensive analysis of the emergency financing needs of the Region was carried out, country demand for fast-disbursing PBL operations far exceeded the 15% limit set in the IDB-8, and discussions began on eliminating the limit for the duration of the crisis.

1.14 These discussions forced the Bank to confront possible financial constraints on its lending program. Traditional investment loans required long preparation times, substantial counterpart funding, and disbursed against identified expenditures spread out over a period of years. These characteristics limited both the number of such loans that could be approved in a given period, and the speed with which disbursements on these loans would add to the Bank's OLB. PBLs however, could be prepared quickly, had no counterpart requirements, disbursed against compliance with policy conditions (and thus could be of any size) and were expected to disburse very quickly.

1.15 An open-ended program of PBLs, therefore, could potentially breach the limits on the OLB established by either the borrowings policy or the RLR. Addressing these issues required a forward-looking financial analysis of lending capacity, something that had not previously been required given the assumed stability of the lending program and the substantial lending authority contained in the large IDB-8 increase.

1.16 To carry out such an analysis, Management had to make assumptions regarding the future course of "ordinary" lending operations (both investment and PBL) and then determine how much additional lending capacity would be available to support an emergency lending program. Management was unable to generate a "bottom up" scenario for future lending based on individual country needs, and so the task fell to the Bank's Finance Department. Since the early 1990s, FIN had been carrying out forward projections to determine how present approvals would translate into future outstanding loan balances. Much of this forward planning was based on the "Sustainable Level of Lending" (SLL) concept that had been first presented to the Governors in 1992.

1.17 The SLL calculation takes contractual repayments on existing loans together with future disbursements on both new and old loans to arrive at a projection of the future OLB. The future OLB is constrained in the calculations never to violate either 90% of the lending authority limit defined by the borrowings policy[4] or the 20% RLR floor established by the capital adequacy policy. As a planning tool, the SLL determines how large an approvals program the Bank could sustain <u>each year</u> indefinitely without requiring an increase in Bank capital. For the 1998 emergency lending calculations, the SLL was found to be $8 billion per year, consisting of 15% fast-disbursing PBL and 85% investment lending.

1.18 Taking the $8 billion SLL as a base case (15% PBL, 85% investment lending), the financial analysis showed that the Bank could lend up to an additional $8.8 billion in fast disbursing emergency lending in 1998 and 1999 and not "erode its

[4] Management calculations provide a 10% "buffer" between the actual forecast OLB and the maximum permissible OLB in the model.

sustainable level of lending."[5] These projections were based on the special financial terms and conditions of emergency loans being offered by the World Bank, terms which the Governors asked the IDB to adopt to avoid having different pricing for the two different institutions. A higher interest rate on emergency loans (400 basis points over LIBOR), allowed the Bank to maintain its RLR target[6], while shorter maturities (5-year amortization) prevented the emergency program from "crowding out" ordinary lending in the future.[7]

1.19 The emergency lending program ended in 2000, and the Bank continued to experience more demand for PBL operations than the 15% limit established in the IDB-8 agreement. By the end of 2000, Management had become convinced that a modification of this limit was required, and opened a dialogue with Governors on "selected lending issues," the centerpiece of which was the need to modify the PBL approvals limit.[8]

1.20 Management defined the challenge in a background paper prepared in May, 2001:

> *The Bank has been asked to prepare an analysis of the financial impact of maximizing the amount of fast-disbursing lending that can be sustained on an annual basis, based on an assumed level of conventional lending and consistent with sound financial management. The Sustainable Lending Level (or SLL) can be seen as constrained, on one hand, by the Bank's lending authority,* **,** *which cannot be exceeded and, on the other hand, by its capital adequacy (currently measured by the Reserves-to-Loans Ratio, or RLR) requirements which, in the cases we are testing, is stated as a floor below which the Bank's risk-bearing capacity would be compromised. Thus, at any point in time, the Bank's projected lending ability could be constrained either by the lending authority or the capital adequacy, depending on the financial situation of the Bank and the type of scenario being conducted. The SLL must be such that neither of these two constraints is violated.*

1.21 This was much the same problem as the Bank confronted in 1998 with the first emergency lending program: demand for fast-disbursing lending was pressing against the constraints of lending authority and capital adequacy, and the only tool available to manage these competing demands were the future projections embedded in a sustainable level of lending model.

1.22 Over the course of 2001, discussions centered on alternative future lending programs built around the desire to maximize fast disbursing lending while

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5 GN-2031-1, paragraph 10

6 The projections actually showed the RLR falling below 20%, but only for a single year, after which the higher interest rate would quickly restore reserve levels.: "*the emergency loans will reduce the RLR in the short run, but permit a faster RLR growth in the future, because: 1) the larger OLB resulting from the emergency loan program generates additional income which is passed on to reserves; and 2) as these loans are repaid, the OLB is reduced thus permitting a faster growth in the RLR*. Paragraph 2.02

7 "*If emergency loans were to be provided under a standard amortization period of 20 years, the Bank as of the commencement of the emergency loan program, would need to decide immediately what part of its future lending program would be delayed or removed*. GN-2031-1, paragraph 2.07

8 CA-423 "Selected Lending Issues" March, 2001. In addition to modification of the PBL limit, the document identified two other issues: a need to change the Matrix of foreign exchange financing, which was contained in the IDB-8 agreement and required Governor's approval to modify; and a desire to develop new investment lending instruments, which did not require action by Governors.

maintaining an ongoing program of investment lending. As with the prior case of emergency lending, these discussions were not based on a detailed assessment of country development needs or absorptive capacity. Instead, the discussion focused exclusively on the financial limits to Bank lending.

1.23 The final proposal submitted to Governors as the first "New Lending Framework" in 2002 contained the following description of future lending limits

> *The proposal consists of (i) replacing the 15 percent cap on PBL by a numerical limit of US$4.5 billion (US$1.5 billion annual average) for the period 2002-2004; (ii) establishing a minimum disbursement period for investment loans (36 months); and (iii) creating a special lending window consisting of emergency loans and short-term disbursement loans. Consequently, the Bank's lending framework would include three lending windows: investment lending, PBL, and special lending* [9]*.*

1.24 Each category of lending had its own constraints derived from the SLL calculations. PBLs had a specific limit on approvals, emergency loans had a limit of $6 billion on the amount of such loans outstanding at any given time, and investment loans were required to disburse over a minimum of 36 months (to maintain the disbursement pattern in the SLL model for such loans). The document also mentioned that investment loans were subject to another limit, but did not specify precisely in numerical terms what this limit meant:

> *Within the sustainable levels of Bank's lending capacity, there shall be no limit (or cap) to investment lending, which continues to be the core business of the Bank.*[10]

1.25 The Governors accepted Management's proposal, and in doing so, created the first comprehensive constraints imposed on the entire lending program since the adoption of the IDB-8. While the Governor's resolution was silent on the quantitative limits to investment lending, a background analysis presented to the Board of Directors in 2003 made it clear that this type of lending had similar approvals limits, derived from the SLL calculations:

> *For the new lending framework, approved by the Board of Governors in March 2002, the amount calculated to be the SLL was $8.15 billion (comprised of $5.15 billion of investment lending, $1.5 billion in fast disbursing lending and an emergency lending program with a ceiling of $6 billion, or, approximately, a $1.5 billion annual program of emergency lending).*[11]

1.26 The same document provided the following chart (Figure 1.3) showing that utilization of the resources provided in the 2002 agreement would take the Bank's OLB to the lending authority limit in each year between 2006 and 2010, and thus represented the maximum "Sustainable Level of Lending" that the Bank could achieve.

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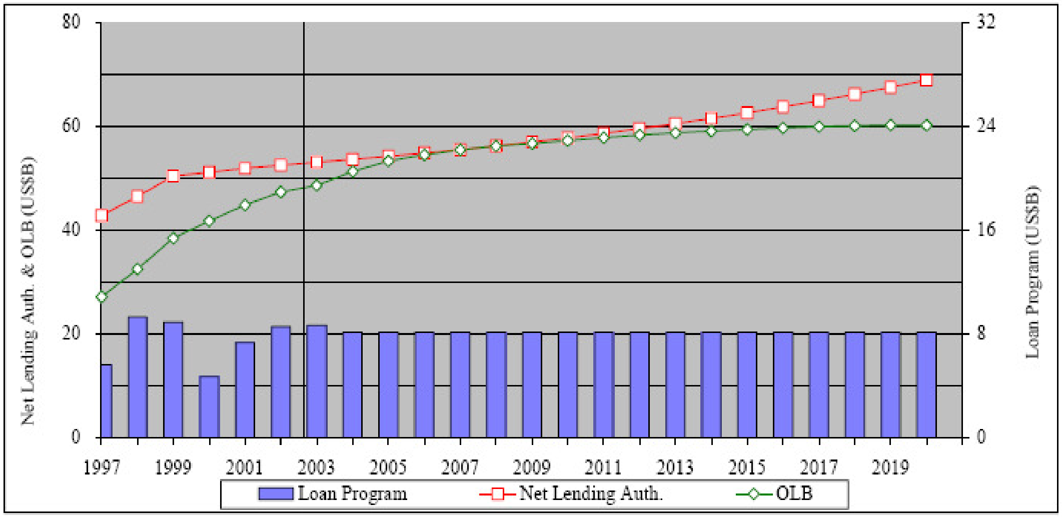
[9] CS-3399 "Management Proposal - Lending Framework." January, 2002

[10] CS-3399 January, 2002. Paragraph 11

[11] CS-3424-2 "OC Financial Model: ALM Framework & Financial Mechanics," paragraph 5.2

Figure 1.3

Sustainable Lending Level



1.27 The projected scenario did not, however, unfold as planned. As the Bank moved to implement the lending authorized by the first NLF, circumstances in the Region caused a significant slowdown in demand for the Bank's resources. Management projected that total 2002 lending would come to only 55% of the originally established SLL, and the 2003 program would come to only 46%, of the originally-established SLL, as is shown in the following table from Management's document. This is not surprising, since the lending program for the period had been defined by the financial ability of the Bank to lend, rather than the needs or capacities of the countries to borrow.

Table 3.2

Available & Actual OC and FSO Lending Balances, 2002-2004

(Amounts in US$ millions)

		2002		2003		2004	
	Sustainable Lending Level	**Actual Lending**	**Available Balance**	**Actual Lending**	**Available Balance**	**Projected Lending**	**Available Balance**
OC Resources							
Investment	5,150.0	3,139.4	2,010.6	1,546.4	3,603.6	3,669.3	1,480.7
PBL	1,500.0	500.0	1,000.0	1,500.0	1,000.0	1,600.0	900.0
Total OC Regular Lending	6,650.0	3,639.4	3,010.6	3,046.4	4,603.6	5,269.3	2,380.7
Emergency	6,000.0	500.0	5,500.0	3,180.0	2,320.0	200.0	2,120.0
Total IDB OC Lending		4,139.4		6,226.4		5,469.3	
FSO Resources							
Investment	400.0	378.6	21.4	373.7	26.3	479.3	(79.3)
PBL	100.0	30.0	70.0	200.0	(30.0)	70.0	0.0
Total IDB FSO Lending	500.0	408.6		573.7		549.3	

Source: GN-2200-13, New Lending Framework (NLF). Assessment report and recommendations April, 2005

1.28 As the NLF-1 period drew to a close, Management again approached the creation of a successor lending framework by asking the financial projections of the SLL to define the future program. For this new exercise, however, Management provided a clear analysis of alternative mixes of instruments that could be accommodated within the SLL framework. The table below, taken from GN-2200-13, showed the basic options presented by Management to the Board.

Table 4.1

Projected Lending Levels: Increases to the Maximum Annual Amount of Investment Lending and Regular PBLs

(Billions of US$)

	Lending – Regular Lending (non-emergency): Investment (annual lending)	Regular PBLs (annual lending)	Total	Emergency (program)
Base Case				
1 Existing SLL/Emergency	5.15	1.50	6.65	6.00
Alternative Scenarios				
Maintaining & fully using existing US$6B EL				
2 Increase in Investment Lending	7.25	1.50	8.75	6.00
3 Increase in regular PBLs	5.15	2.45	7.60	6.00

Table 4.2

Projected Lending Levels: Increase in Regular Lending at the Expense of the Emergency Program

(Billions of US$)

	Lending – Regular Lending (non-emergency): Investment (annual lending)	Regular PBLs (annual lending)	Total	Emergency (program)
Alternative Scenarios				
Assumes No EL program				
4 Increase in Investment Lending	8.55	1.50	10.05	-
5 Increase in regular PBLs	5.15	3.05	8.20	-

Source: GN-2200-13, New Lending Framework (NLF). Assessment report and recommendations April, 2005

1.29 At the conclusion of negotiations on the 2005-2008 NLF, the Board of Executive Directors recommended that "option 3" in the table be chosen (increased PBLs while maintaining an emergency program at $6 billion). The Governors approved these quantitative targets, while making some adjustments to some other financial parameters. The minimum disbursement periods for investment lending contained in the prior NLF were eliminated, and while PBL operations were authorized up to $2.45 billion per year, ($9.8 billion over the four-year period) the Governors also established a limit of $7.6 billion on PBL disbursements for the four-year period.

1.30 In addition to approving these lending limits, the Governor's resolution went beyond the previous NLF in three important respects: 1) it established expectations for regular renewal of future four-year lending frameworks; 2) it explicitly asked the Governors to approve "SLLs" for each major lending category; and 3) it introduced capital adequacy as an explicit constraint on the SLL. Specifically, the Governor's resolution stated:

> *The Board of Governors would authorize new SLLs for investment loans, PBLs and emergency loans during any consecutive four-year period, the first of which shall begin on January 1, 2005 and end on December 31, 2008, after adjusting the existing SLLs by new terms and conditions, current financial information,*

and consistent with the Bank's capital adequacy policy and lending authority, as well as with the Bank's Charter.

1.31 It is not clear from the supporting text why the language of the resolution asks Governors to "authorize new SLLs" for each lending instrument over succeeding four-year periods. The SLL is an analytical construct, based on forward projections of multiple variables, and containing a large number of assumptions. Governors had never previously been asked to approve SLLs, even though the limits they did approve were based on SLL calculations. Having the Governors "authorize new SLLs" thus elevated the SLL construct from a financial planning tool to the sole basis for operational guidance.

1.32 As was seen in the case of emergency lending, capital adequacy calculations had always played some role in the dimensioning of a lending program. The reference to the "Bank's capital adequacy policy", however, referred to the new policy adopted in October 2003 that replaced the prior Reserves to Loan Ratio (RLR) with a Total Equity to Loans Ratio (TELR) as the measure of the Bank's capital adequacy. According to that policy, the TELR should fall within a range between 32% and 38% for the Bank to have the appropriate level of capital to support the risks in the portfolio.

B. Evaluating limits

1.33 The preceding section documents the evolution of approvals limits, from the open-ended program of the IDB-8 through an implicit SLL-derived 2002 NLF agreement to the explicit endorsement of ex-ante SLLs for each lending category in the 2005 NLF. This evolution represented a steady increase in reliance on financial calculations for determining the Bank's anticipated future lending program. In doing so, the Bank asked an analytic tool (the SLL) to do a task for which it was not designed. The following two sections of this evaluation will document the operational consequences of this decision, and explore in detail why the SLL method is not appropriate for the use chosen. Since much of the analysis will focus on the limitations of the SLL methodology, it is important to note that the problem is not that some better financial technique was available, but rather that financial projections cannot serve the Bank well as the sole mechanism for determining the size of a future lending program.

1.34 **Operational consequences**. As noted above, the lending limits in the first NLF (2002-2004) did not pose any significant constraint on the operational program. Approvals were well below limits for the period, and the caps by instrument did not have any operational consequences. For the 2005-08 NLF, however, the limits did pose significant issues for the development of the operational program.

1.35 Management typically presents a brief discussion of the anticipated lending program along with the budget proposal sent in October of the prior year. The "Program and Budget" proposal for 2007 made no mention of NLF lending constraints as a potentially limiting factor for the lending program, but the 2008 budget sounded an alarm concerning lending limits:

Lending in 2008 is projected to range from $5.6 billion to $8.2 billion…. It must be noted however, that the Ordinary Capital (OC) lending limitations placed by the New Lending Framework (NLF), approved in April 2005 by the Board of Governors, might pose a financial constraint to reaching this target unless a transfer of funds is authorized from available resources for Policy-Based Lending (PBL) to investment lending in 2008. [12]

1.36 The document predicted that 2007 would consume $6.572 of NLF approvals authority for investment lending, leaving $4.287 billion available for 2008.

1.37 In March 2008, however, Management brought forth another document that indicated that the situation had become significantly more constrained than anticipated in the budget submission. 2007 approvals had been higher than forecast, leaving only $2.891 in NLF approvals authority to finance an estimated 2008 pipeline of over $9 billion. PBL and emergency approvals, in contrast, were well below NLF limits. (See Tables 1 and 3 from AB-2584 below) [13]

Table 1
NLF OC Limits and Current Utilization
(US$ million)

Lending Category	NLF Limits 2005-2008	Approved/ Disbursed 2005-2007[b]	Amount Available for 2008	Pipeline 2008	Deficit/Surplus of Funds for 2008 Lending
Investment Lending [a]	20,600	17,708.7	2,891.3	9,045.4[c]	(6,154.1)
PBL Lending	9,800	3,598.8	6,201.2	3,552.5[d]	2,648.7
PBL Disbursements	7,600	2,900.0	4,700.0		
Emergency Lending	6,000	---	5,370.0[e]	----	5,370.0

/a. Includes public and NSG lending plus guarantees.
/b. Source: POIS Tables for lending; FIN for disbursements
/c. Figure includes a 30% dropout rate which corresponds to the historical average for investment loans.
/d. Includes pipeline A and B.
/e. This amount is less than US$6 billion because it excludes the outstanding loan balance.

Source: AB-2584

12 GA-238 "2008 Program and Budget, October 15, 2007", paragraphs 2.11 & 2.12
13 AB-2584 "Request for authorization to exceed the lending limit for investment lending under the New Lending Framework (NLF) 2005-2008", April 1, 2008.

Table 3
OC Approvals by Lending Category for NLF 2002-2004 and NLF 2005-2007
(US$ million)

Lending Category		Approvals NLF 2002-2004	Approvals[b]			Approvals NLF 2005-2007
			2005	2006	2007	
Investment Lending[a]	SG	7,242.4	4,967.5	3,149.1	5,670.7	13,787.2
	NSG	1,116.8	683.0	939.8	2,298.7	3,921.5
Total Investment Lending		8,359.2	5,650.5	4,088.9	7,969.4	17,708.7
PBL Lending		3,600.0	1,080.0	1,675.0	843.8	3,598.8
Emergency Lending		3,880.0	--	--	--	--

/a Includes public and NSG lending plus guarantees.
/b Source: POIS tables

Source: AB-2584

1.38 Management requested, and the Governors approved, a transfer of lending authority (permitted under the NLF agreement) from PBL to investment lending. With this transfer, the Bank received 2008 approvals authority of $5.7 billion for investment lending, as against a pipeline of over $9 billion.

1.39 The precise operational consequences of available approvals authority equivalent to only 63% of the pipeline will only be known as the 2008 lending program unfolds. In its request for transfer of lending authority, Management indicated that it would: "*prioritize project preparation during the year to conform to the NLF envelope, and to continue building the 2009 pipeline.* [14] It is not clear from the document how much of the pipeline was ready for approval in 2008, and delayed solely by virtue of limited lending authority.

1.40 The 2008 situation illustrates three operational consequences of the NLF constraints. First, the NLF is written as a four year constraint, but implemented as a one year constraint. All the adjustment in approvals is taken in the final year of the framework, with no evidence that the limits induce programming changes in prior years.

1.41 Second, the ability to transfer approvals authority between investment lending and PBL raises fundamental questions regarding the rationale for separate approval limits in the first place. Management's proposed transfer of lending authority made no attempt to justify the shift from one category to another on substantive or developmental terms. The only analysis offered was that $2.2 billion in unused PBL authority would generate $2.9 billion in investment lending authority because the different disbursement rates consumed different amounts of lending authority.

1.42 Third, there is an anomaly in the way the Bank manages different portions of its investment lending program. The NLF approvals ceilings apply to both sovereign and NSG operations, creating a situation in which one type of investment lending

[14] Report on the 2007 and 2008 Lending Programs and the Lending Program Updates GN-2477. 19 March 2008.

could potentially "crowd out" the other. NSG operations are subject to a limit of 10% of the Banks outstanding loan portfolio, a limit which was imposed by Governor's decisions taken outside of the NLF. Inside the NLF, they are governed only by the limit on investment lending approvals, even though NSG operations are every bit as distinct a lending category as PBL, which is separately constrained.

1.43 Thus the NLF contains an explicit cap on investment lending ($20.6 billion) but there was not even a projection of how much of this authority NSG lending would consume. In 2006, Management presented an Integrated Business Plan for NSG operations, which contained the following language:

> *Over the 2007-2010 period, approvals of IDB's NSG operations in dollar terms are projected to increase to approximately US$4 billion in aggregate, supporting investments in the order of US$20 billion.*[15]

1.44 This projection suggested annual approvals limits of $1 billion per year for four years, approximately 20% of the NLF investment lending program. In fact, NSG approvals in 2006 were just under $1 billion, but jumped to $2.298 billion in 2007, and presented a pipeline for 2008 of some $3.846 billion. The 2008 pipeline for NSG thus came to 42% of the $9 billion overall investment pipeline.

1.45 It thus appears clear that the absence of a specific approvals limit for NSG investment lending has resulted in a dramatic expansion of the share of total investment lending accounted for by this instrument.

1.46 **Issues with using the SLL to define a lending program**. The SLL is an analytic construct that allows a financial institution to project how much lending it can do in the future without requiring a capital increase. It does not describe how much the institution should do in light of the needs of the borrowers. Nor does it define whether the Bank has the capacity to produce, or the countries have the capacity to consume, developmentally sound projects within the given envelope of financial resources. Answers to each of these other questions required the Bank to carry out a detailed analysis of country needs and Bank capacity. This was not done. As a result, the SLL calculations were asked to bear the entire weight of determining the size and composition of the Bank's future lending program. In making this decision, the IDB became the only financial institution, multilateral or otherwise, to use SLL calculations as the sole basis for defining ex-ante limits to the lending program.

1.47 The SLL construct emerged in the World Bank during the 1980s, but as a planning tool, not a tool for setting approvals limits.

> "*The concept of the SLL was introduced in the mid-1970s in response to shareholder concern that decisions on IBRD capital should not be taken under duress. The idea was for the shareholders to take up the question of a capital increase at a time when a negative decision (i.e. a decision not to increase*

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[15] GN-2400-6 "*Integrated business plan for non-sovereign guaranteed operations*." 30 June, 2006, paragraph 4.1.

capital further) would not force the Bank to cut back its new lending so abruptly as to be disruptive.

In practice, the SLL has not been treated as a rigid ceiling on the IBRD's level of annual commitments, but rather as an approximate indicator of when decisions on new capital are required.[16]

1.48 When the IDB first explored the SLL tool in the 1992 paper for Governors, a number of Governors requested that Bank Management provide a "replenishment trigger" calculation similar to that used in the World Bank. Management accepted this suggestion, noting *"It is important to make clear, however, that the use of an SLL approach in no way precludes the possibility of future capital increases,"*[17] and provided a background paper on how such a trigger could be constructed.

1.49 The 1992 IDB document also made clear that SLLs were a financial projection and not meant to define a desirable future lending program. The paper noted that although the SLL methodology calculates the amount of yearly approvals that could be done indefinitely,

It is important to note that, in spite of the use of the word "sustainable", the SLL approach does not necessarily mean that the projections of future levels of lending must be constant. Lending programs could be constructed that are front-end or back-end loaded, that either grow to a specific year and then level out, or that grow up to a point in time and then drop to a new lower level.[18]

1.50 When the Governors approved the IDB-8 agreement in 1994, they elected to remain silent on the issue of the a sustainable lending level for the Bank, and instead were quite clear on what they expected would be the determinants of the Bank's annual lending program:

Actual lending in any given year will vary depending on the borrowers' needs and capacities, the state of the Bank's project pipeline, and the Bank's capacity to prepare good projects.

1.51 Yet as noted earlier, the first NLF agreement (2002-2004) was not based on an analysis of "borrowers needs and capacities," nor the Bank's "capacity to prepare good projects." As Management described the SLL calculations in response to questions from the Board in 2006:

Thus the SLL represents the maximum constant lending supply the Bank could maintain. It does not represent a projection of demand for Bank loans[19].

1.52 Using the SLL to actually define a lending program carries with it a number of fundamental problems related to the assumptions made by the method itself. Assumptions regarding certainty, perpetuity, exclusivity, and passivity make the SLL methodology a useful tool for making future projections but a poor tool for setting

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16 Technical Note Alternative Measures of IBRD Capital Adequacy SEC-M87-629, June 2, 1987).

17 CA-341-1, paragraph 3.2.

18 CA-341-1, paragraph 3.22.

19 FN-602-2 "*Management's response to additional questions from the Board of Executive Directors on the disposition of equity above 38% TELR*", page 6.

short-term limits to loan approvals, within a context of an overall constraint on long-term lending authority.

1.53 To examine the assumptions behind the SLL model, OVE has carried out a detailed review of the spreadsheets used in 2004 to establish the SLL projections that were embedded in the 2005-08 NLF. The charts that follow are taken directly from these spreadsheets, and therefore do not represent current values or projections. They do reveal, however, what was known at the time, and thus illuminate the assumptions and limitations embedded in the SLL methodology itself.

1.54 **Certainty.** Using SLL calculations to define a short term limit on approvals carries the assumption that the model predicts, with a high degree of certainty, the future consequences of a given level of approvals. In the 2005-08 case, the precise limit on approvals was given as $7.6 billion per year, not $7.5 or $7.8, or some range of values. A detailed analysis of both this and past SLL projections shows little grounds for accepting the certainty hypothesis.

1.55 Table 10 below, taken from Management's response to questions from Executive Directors in 2006, show how these projections have shifted over a relatively short period of time. It shows the variation in both the size of the SLL and the "crunch point year" (the year in which the OLB makes its closest approach to the lending limit defined by the borrowings policy).

Table 10. Reported SLL values corresponding to four historic and actual time periods.

	8th Replenishment	EME Lending \1	1st NLF 2002 - 2004 \3	2nd NLF 2005 - 2008 \3	Financial Outlook FN-608 \4
SLL (INV)	$6.50 bn	$6.8 bn	$5.15 bn	$5.15 bn	$5.15 bn
SLL (PBLs)	$1.15 bn	$1.2 bn	$1.5 bn	$2.45 bn	$2.45 bn
SLL (Total)	$7.65 bn	$8.00 bn	$6.65 bn	$7.60 bn	$7.60 bn
EME approvals	n.a.	$8.8 bn \2	$6.0 bn OLB	$6.0 bn OLB	$3.0 bn OLB
Crunch point year	2015	2013	2010	2015	2019

\1 Includes a one time maximum level of EME approvals such that RLR (capital adequacy indicator at the time) would drop below its policy minimum in 1999 before recovering by 2000 (GN-2301-2)

\2 The one time $8.8 bn was broken-down as $5.8 bn and $3.0 bn in 1998 and 1999 respectively (GN-2031-2). Actual approvals amounted to $3.1 bn and $4.6 bn in '98 and '99 respectively for a total of $7.6 bn

\3 A $6 bn EME OLB program corresponds to an average annual approval amount of $1.5 bn

\4 Represents a $3 bn reduction in the $6 bn EME OLB program from 2007 to 2010, and $0 bn thereafter

Source: FN-602-2

1.56 Management was clearly aware of the inherent uncertainty in SLL projections, and has sought to protect the Bank from miscalculation by establishing a financial "buffer" in the projections to further reduce the possibility of breaching lending authority ceilings. As described in a 2001 analytical paper:

> *Considering that the lending authority in the future is based on financial projections and uncertain assumptions, and that a breach of the authority could have a significant cost to the Bank's borrowing members, it becomes necessary for Management to create a lending authority "buffer", so that the possibility of*

a violation is reduced. The difference between the ceiling of the lending authority and the sum of outstanding loans and liabilities from guarantees (i.e. OLB) is what is referred to as the "headroom". In order to provide a measure of protection against the Bank ever reaching its lending authority, management projects future approval levels so that the headroom never falls below 10% of the lending authority. Management refers to this 90% lending authority (operational ceiling) as the "net lending authority."[20]

1.57 The buffer thus acts to reduce overall approvals below the level suggested by the calculations. It acknowledges uncertainty, but manages it asymmetrically, through a further restriction on allowable approvals.

1.58 There is a further dimension to the concept of the "buffer" related to emergency lending. Since 2002, when a permanent emergency program was agreed to by the Governors, Management's SLL calculations have asked the buffer to do double duty: protect the Bank against inherent forecast uncertainty, and provide a pool of resources always available to fund the $6 billion emergency line.

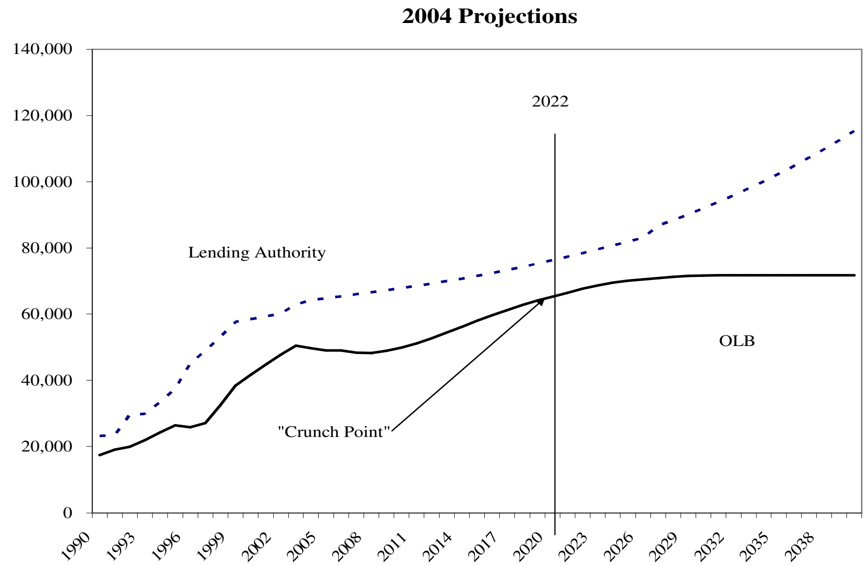
1.59 Because of this treatment, an emergency program per se is not modeled in the SLL spreadsheets. While specific assumptions are made for approvals and disbursements of investment and PBL operations, none are made for emergencies. Emergency loans, however, carry both higher interest rates and shorter tenors than other Bank loans, and thus have an impact on both OLB and lending authority that is not captured in the projections. Emergency loans repay over 5 years, and thus have only a very short-term impact on the OLB. In fact, if a $6 billion emergency program had been approved in 2005, it would have been repaid by 2010, only two years beyond the NLF approvals window. They would have no effect on the OLB thereafter.

1.60 Such an emergency lending program, however, would have a strong influence on lending authority, since the higher interest rates would add to accumulated Bank reserves (and thus lending authority) at a much faster rate than regular loans. The income from PBL and investment loans is built into the lending authority calculations, while the income from emergency lending is not. Failure to model an emergency lending program thus understates future lending authority, and acts to lower the SLL. In effect, the emergency program becomes a line of credit with no clear triggers and no commitment fee.

1.61 **Perpetuity.** A second major issue with the use of the SLL to define annual approvals limits is that the concept itself assumes perpetual approvals at the same level. How much the Bank can lend forever is a much different question from how much can be lent this year, or the next two years. Figure 1.4 taken from Management's 2004 spreadsheets, shows the problem with the perpetuity assumption.

[20] GN-2157-1 *"Financial impact of scenarios assuming increases to the rate of and amount of fast disbursing lending*" Annex A, paragraph iii.

Figure 1.4



Source: 2004 SLL Spreadsheet

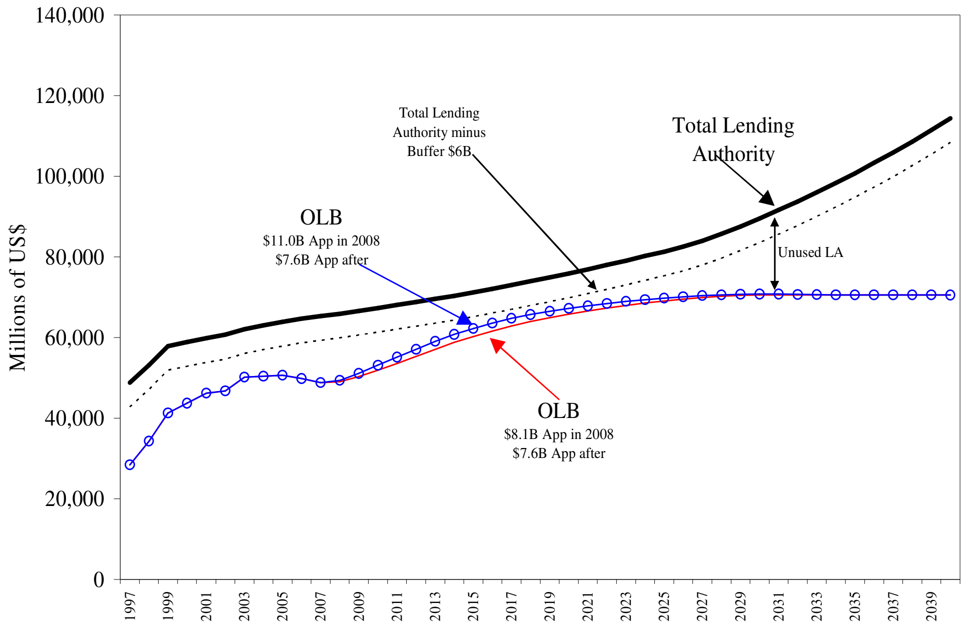
1.62 Based on a presumed SLL of $7.6 billion per year, the model shows that the projected OLB is always less than the projected lending authority (the "buffer" assumption), but that the closest approach of the forecast OLB comes to more than $10 billion below lending authority, and that this "crunch point" occurs in 2022, and lasts for only a few years before lending authority grows faster than the OLB.

1.63 The chart demonstrates two points. First, the SLL does not represent the maximum that could be done in perpetuity, merely the maximum that could be done until the "crunch point" is reached. Second, after the "crunch point," the SLL is considerably higher than that established prior to the crunch point. The SLL construct, therefore, limits annual approvals to an amount that satisfies inherently uncertain projections of a crunch scheduled to arrive in 2022, rather than representing perpetual approval authority.

1.64 The operational consequences of combining a perpetuity assumption in an inherently uncertain projection are quite dramatic. As an example, OVE has calculated, using Management's 2004 spreadsheet, the consequences of approving a lending program for 2005-2008 which uses the actual approvals for 2005-2007, and defines a 2008 expanded lending program using Management's estimates of an $11 billion plausible approvals pipeline. Holding all other elements of the spreadsheet constant, and assuming the Bank reverts to lending $7.6 billion in 2009, the projections show that such a lending program could be accommodated without breaching the approvals ceiling, or even breaching the "buffer" (See Figure 1.5). The problems encountered in 2008 because of a shortfall of approval's authority are thus not a dictated by actual capacity to lend but instead by the ex-ante constraints imposed in 2005.

Figure 1.5

Hypothetical $11b 2008 Lending Program



Source: 2004 SLL Spreadsheet

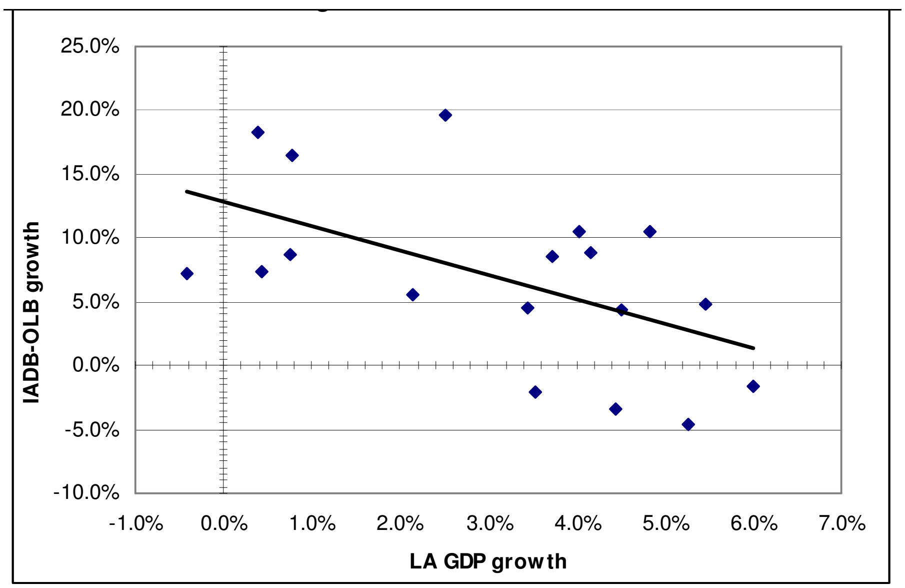
1.65 **Exclusivity.** By its very nature, the SLL approach assumes that restricting annual approvals is the exclusive tool available to the Bank for managing the future OLB. Yet the future OLB is obviously influenced by a variety of factors other than current approvals. Chief among these is the rate at which current approvals disburse into the OLB. Management's SLL calculations use a weighted average disbursement profile derived from the past 20 years of data on Bank lending. From that same data, however, OVE was able to construct both high and low disbursement profiles. Under a high disbursement profile, the SLL falls from $7.6 to $7.05 billion per year, but under a low (slow) disbursement profile assumption, the SLL rises to $10.62 billion. Thus the pace of disbursement, a variable jointly managed by the Bank and the country, can clearly influence the trajectory of future OLB, and thus the current SLL.

1.66 Other actions can also have a significant impact. Prepayments by borrowers (which are not modeled in the spreadsheet) have recently taken place, reducing the projected OLB. Cancellations, which are modeled at a constant rate, have in fact been highly variable over time, as they are frequently used by new governments as part of the process of setting new investment priorities. Commercial banks regularly sell off portions of their existing lending portfolio in order to make space on the balance sheet for new lending. Management has currently identified $300 million in NSG lending that could be made available for sale, and there is no ***a priori*** reason why sovereign guaranteed loans might not be amenable for similar treatment.

1.67 Finally, it is by no means certain that the Bank's only (or even best) option for supporting member governments is by putting assets on the Bank's balance sheet. With the rise of sovereign wealth funds and other large pools of investment capital, there may be situations in which the Bank's contribution might be maximized by preparing projects for placement on these other balance sheets rather than its own.

1.68 **Passivity.** The use of the SLL to define a lending program also assumes a passive and invariant lending program, not one that is reactive to the changing economic dynamics of the Region. The same volume of new approvals is assumed if the Region is booming or in recession. Figure 1.6 demonstrates, however, that demand for IDB disbursements is affected by the economic cycle. IDB loans are more demanded in low pace growth periods, explaining the negative relationship between economic growth in Latin America and growth of IDB's outstanding loan balance (OLB).

Figure 1.6
OLB Growth Relative to GDP growth



1.69 The observed responsiveness of Bank disbursements to the economic cycle suggests that both approvals and disbursements are influenced by the current state of the Region's economic cycle. A Bank aiming to be "responsive" to client needs should have a lending framework that recognizes these cyclical fluctuations and includes them in projecting both approvals and disbursements, rather than the passive and invariant lending program assumed by the SLL framework.

1.70 This analysis has demonstrated that assumptions inherent in the SLL method give poor guidance for determining a program of loan approvals. By turning the SLL calculation into the definition of a lending program, the IDB ignored the cautionary warning raised by the World Bank in the early 1980s. In their 1982 analysis of the SLL concept, the World Bank recommended:

"*Using the SLL pragmatically without a strict adherence that would bring unnecessary adjustments and underutilization of Bank resources at times when demands are expanding*"[21].

1.71 As the previous analysis demonstrates, in a variety of ways, the IDB's use of the SLL to define lending program approval limits has led to exactly this type of underutilization of resources.

1.72 This outcome is the inevitable result of using an analytic tool as a substitute for a governance judgment. The appropriate level of capital for the Bank is a policy judgment to be made by the Bank's Governors. The SLL methodology derives a lending limit from the current capital stock, and then manages the approval process so as never to challenge that limit. In contrast, the World Bank uses SLL calculations to inform political decisions regarding the need for capital:

The SLL did not place a rigid ceiling on the IBRD's level of annual commitments but served principally as an approximate indicator of when decisions on new capital were required.[22]

1.73 Used in this fashion, the inherent methodological problems embedded in the SLL become much less significant for the institution. The SLL can signal the approach of a moment when the OLB might breach the lending authority limit, allowing the Bank and the borrowing countries time to react. It also provides information for the Governors that there might be an impending conflict between the desired level of lending and the Bank's capital capacity to support such lending –the so called "replenishment trigger" mechanism described in the Bank's 1992 paper.

1.74 The long-term consequences of avoiding a discussion on the Bank's capital forever can be seen in the long-term projections contained in Management's 2004 SLL spreadsheet. Assuming a maximum SLL that avoids breaching the lending limits defined by current policy and current capital levels, and assuming standard loan charges on outstanding balances, gives the picture of the Bank's long-term future shown in Figures 1.7 and 1.8.

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21 World Bank, Sustainable Level of Lending, p. 8.

22 Devesh Kapur, John Lewis and Richard Webb. The World Bank: Its First Half Century. The Brookings Institution, 1997. p. 995.

Figure 1.7

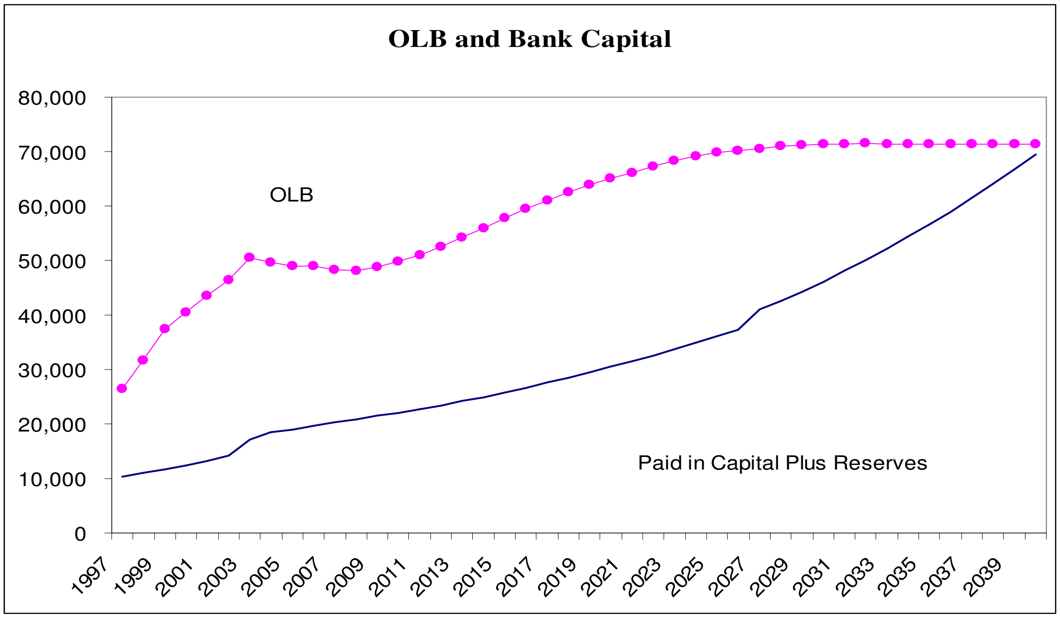
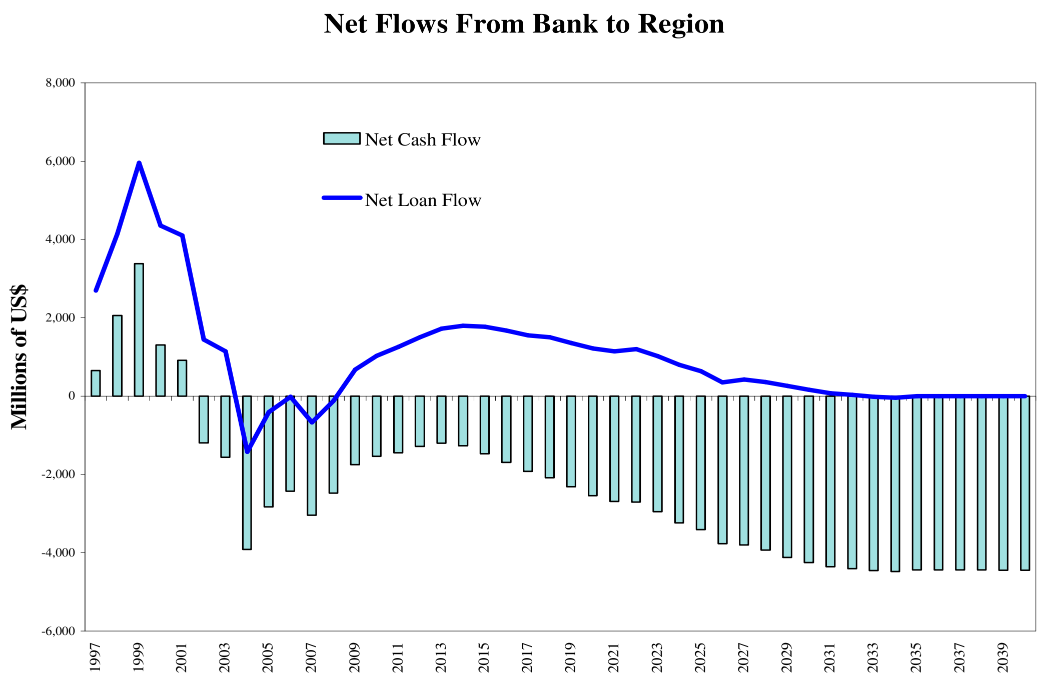


Figure 1.8



1.75 Under the maximum SLL assumption contained in the 2004 spreadsheets, future disbursements allow the OLB to increase for a time, reaching a plateau in roughly 2031. Reserve accumulation, however, brings total capital plus reserves to approximately the same level as the OLB by 2040. (Figure 1.7). While this is taking place, however, the slow growth in the OLB means that annual disbursements from the IDB are less than principal and interest repayments from borrowing countries, leading to persistent net negative cash flow for the entire period. (Figure 1.8). This "SLL Future" contained in the spreadsheets leads to a situation where the Bank takes over $4 billion per year from the Region in perpetuity.

1.76 Ironically, for a forecast derived from sustainability assumptions, this kind of future does not appear to be sustainable. In its 2007 review of the credit ratings on multilateral financial institutions, Standard and Poor's noted that the quality of an individual institution's rating rested on three pillars: financial strength, management quality, and member support. While the institution shown in Figure 1.7 would be financially strong, it is not at all clear that borrowing members would continue to enthusiastically support an institution that was a permanent and growing burden on the Region. S&P warned:

> *Shareholder support from donor and beneficiary countries may change in the future. If additional resources from the donor countries diminish or disappear (due to fewer general capital increases), beneficiary countries may come to regard MLI debt as no different in priority from bilateral government debt, which historically has had a much poorer track record of repayment.*[23]

C. Two limits: Lending authority and capital adequacy

1.77 The preceding analysis has demonstrated that the assumptions of the SLL approach lead to an excessively constrained lending program, and suggested a number of ways in which actions by the Bank might make it possible to support a larger lending program than the SLL calculations would permit without violating the lending authority defined by the borrowings policy and without requiring an additional replenishment of the Bank's capital.

1.78 This flexibility is not infinite, however, and it is likely that a sustained program of approvals larger than those defined by the SLL would eventually challenge the current lending authority limits, leading to either a substantial reduction in future lending or a need to replenish the Bank's capital.

1.79 If this issue arises in the future, the discussion will be complicated by the fact that the Bank has not one but two ways of defining limits on lending: one derived from the borrowings policy and one derived from the capital adequacy policy.

1.80 As demonstrated above, virtually all of the past discussion and analysis regarding the SLL and approvals limits has been based on lending authority as defined by the borrowings policy. The exception to this rule was the first emergency lending program, where capital adequacy constraints limited the size of the program and created the need for substantially higher loan charges on emergency loans. All of the SLL calculations used to establish both the first and second NLF lending programs were managing within the constraint established by the borrowings policy.

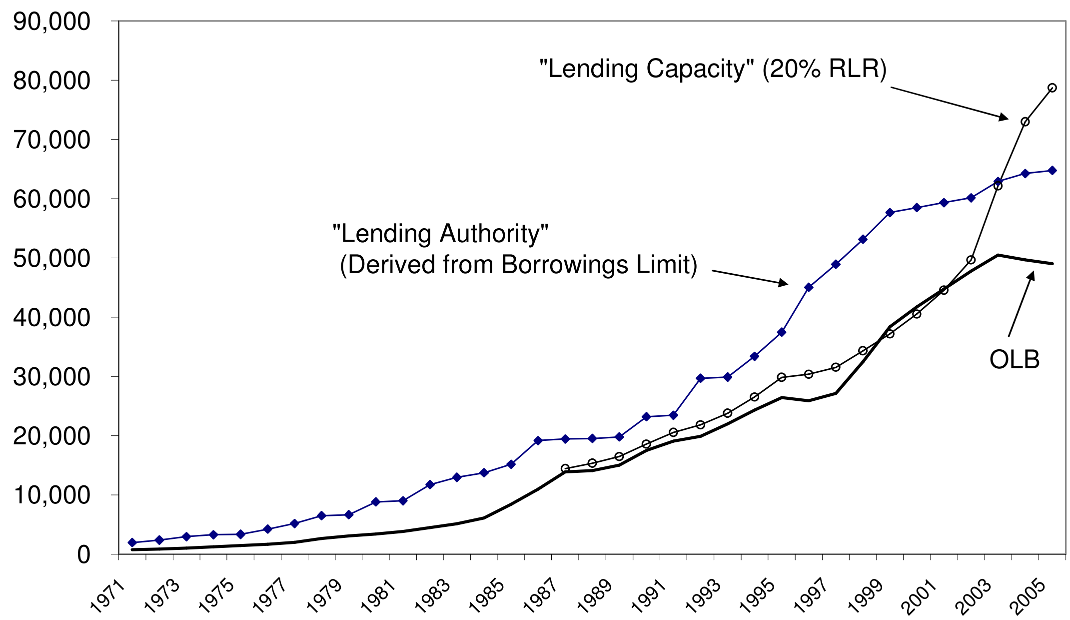
1.81 As noted earlier, while the borrowings limit is based on <u>callable</u> capital, the Bank has also had (since 1989) a capital adequacy policy in the form of the Reserves to

[23] Standard and Poor's "Supranationals: Special Edition 2007 From the Sovereign Ratings Group" October, 2007.

Loans Ratio (RLR). This policy called for the RLR to be maintained within a band of 20% to 25% of the OLB. Figure 1.9 uses the 20% lower band for the RLR to define a hypothetical “lending capacity” limit based on this measure of capital adequacy.

Figure 1.9

Limits on Lending



1.82 The chart shows two important facts. First, “lending capacity” defined by adequate reserves has historically been lower than “lending authority” as defined by the borrowing policy. The OLB remained just under the 20% RLR line (with the exception of the early emergency lending program years) until 2003, but well below the lending authority defined by the borrowing policy. Second, the two measures were on sharply different growth paths. The RLR limit was growing rapidly toward the end of the period, while the borrowings policy limit grew strongly until 2000, but flattened out markedly thereafter.

1.83 This outcome is the result of way the two measures are constructed. Since it is based on callable capital, “lending authority” is strongly influenced by the growth in the callable capital of the non borrowing member countries. The last of the IDB-8 capital subscriptions were received in 2000, after which it is only the growth in reserves that adds to lending authority.

1.84 In contrast, the “lending capacity” measured by the RLR is not affected by capital subscriptions but is much more powerfully influenced by the accumulation of reserves. The reason for this divergence is mathematical: “lending authority” grows in a linear fashion linearly while “lending capacity” grows by some multiple of the growth in reserves (depending on the target RLR). Every dollar of reserve accumulation adds one dollar to "lending authority," but adds $5 to "lending capacity" (given a 20% RLR).

1.85 With the cessation of new capital subscriptions in 2000, the 5:1 leverage in the RLR meant that the amount of lending it would support started to exceed the limits established by the borrowings policy in 2003, and the gap grew steadily for every succeeding year.

1.86 In 2003, however, Management proposed the adoption of a new policy on capital adequacy, one which replaced both the RLR and the loan charges policy of the Bank. In place of the RLR, the new policy measured the Total Equity to Loans Ratio (TELR). Reserves were by far the largest component of "Total Equity", (which also included paid in capital and allowance for loan losses), and in that sense the two measures were similar. The principal difference was that the new capital adequacy model was based on a financial analysis of the risks inherent in the Bank's portfolio, while the RLR was simply a target set without knowledge of the possible risks it was protecting the Bank against.

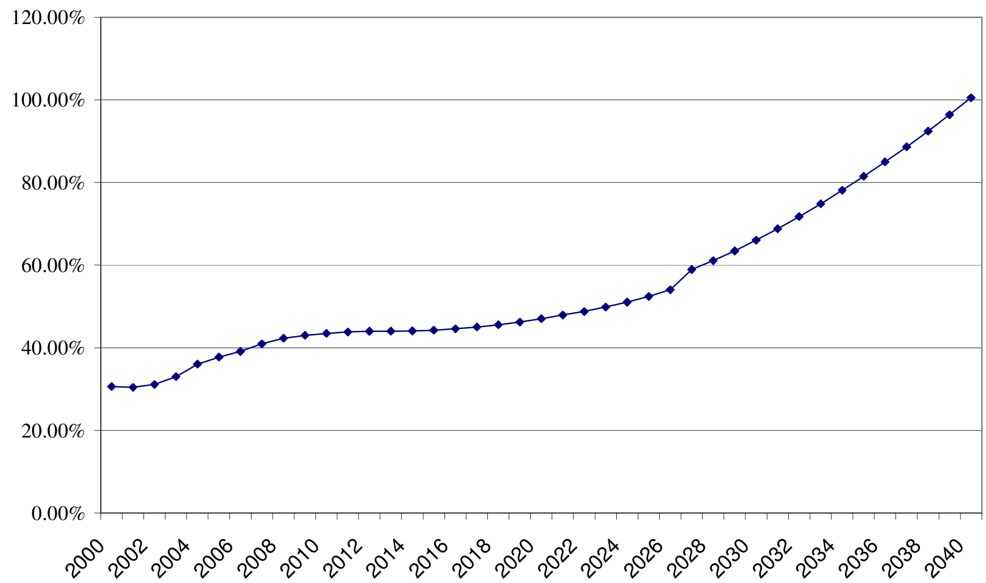
1.87 The risk analysis was strongly influenced by the credit ratings of borrowing member countries, and 2003 was a period of substantial financial stress in the Region. In this environment, the risk analysis suggested that the Bank needed to have Total Equity of at least 32% of the OLB. This was termed the "required TELR" as generated by the risk analysis. Combining this minimum level with a desire for stability in loan charges, Management proposed a policy to keep the future TELR within a band of between 32% and 38%. These bands were enacted by the Board, and became the "policy TELR" within which it was expected that the Bank would manage its exposure.

1.88 In terms of lending limits, the shift from RLR to TELR simply lowered the rate at which reserve accumulation added to the Bank's economic capacity to support the OLB. While $1 of reserve accumulation supported $5 of lending under a 20% RLR constraint, the same $1 of reserve accumulation added between $2.63 (38% TELR), and $3.13 (32% TELR) to lending authority derived from economic capital. Thus the Bank's capacity to support lending with equity increases at roughly three times the rate than does lending authority derived from the borrowings policy.

1.89 The following two charts show the nature of the conflict. Both are based on Management's 2004 SLL spreadsheet. Figure 1.10 shows the forecast TELR assuming that the lending program was constrained by borrowing policy limits to a $7.6 billion SLL, and standard loan charges continued to be applied. Under these assumptions, the TELR <u>never</u> falls within the policy bands, and starts rising rapidly after 2027, peaking at over 100% of the OLB at the end of the forecast period.

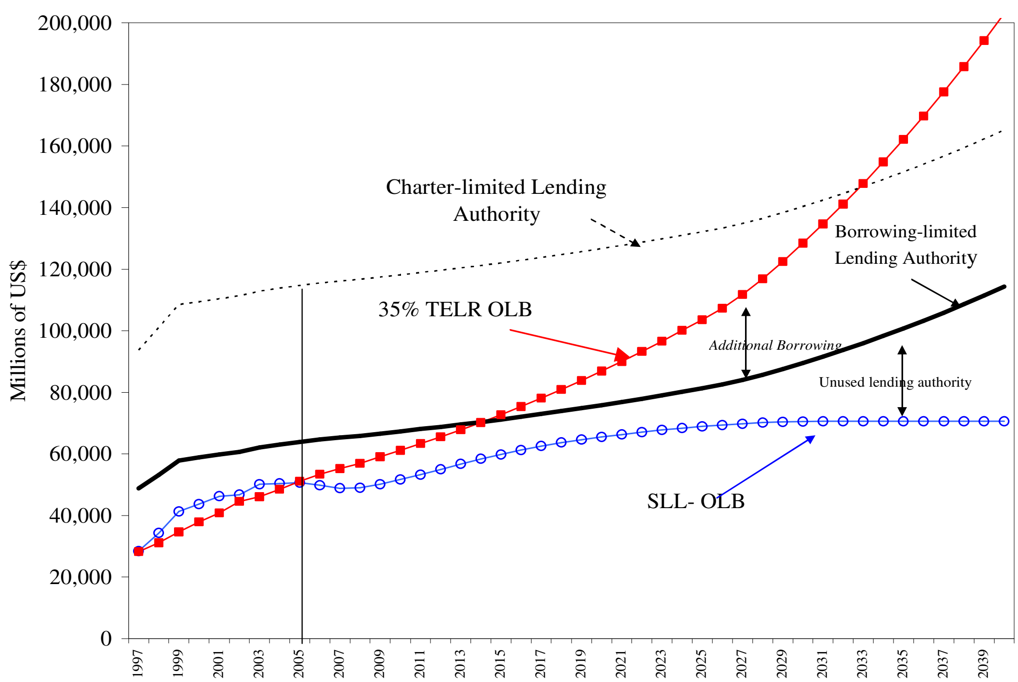
Figure 1.10

Forecast TELR



1.90 Figure 1.11 compares the borrowings-limited lending authority with the "lending capacity" that would be created by maintaining a 35% TELR over the forecast period. It shows that additional borrowing would be required to support this lending program, and that TELR-derived lending capacity would eventually exceed Charter limits.

Figure 1.11



1.91 It is important to stress that these are purely hypothetical extensions of existing policies, and do not represent plausible futures. It is unlikely that the lending program would stay at the SLL limit of $7.6 billion after the "crunch point" and if the actual lending program followed the 35% TELR path, equity would grow even faster than shown, bringing it into conflict with Charter limits much earlier.

1.92 Figure 1.11 thus shows the logical bases upon which the two limits are constructed. The analysis suggests that while the Bank has been able to operate comfortably within both limits in the past, the different results produced by the two approaches are diverging rapidly in the absence of a capital increase, and the Governors may soon be called upon to decide how to manage the situation.

1.93 There are two obvious options: a capital increase or a policy decision to use "lending capacity" (defined by economic capital) rather than "lending authority" (derived from borrowings limits) as the basis for limiting the size of the Bank's lending program. A capital increase would add to both paid in and callable capital, which today still account for most of the Bank's resources, and would thus add to "lending authority" in direct proportion to the increase in the callable capital of the non-borrowing shareholders.

1.94 Changing policy to rely on "lending capacity," on the other hand, might possibly allow for a more rapid increase in the permitted size of the OLB than that made possible under a capital increase. The uncertainty arises from the fact that lending limits derived from capital adequacy calculations depend critically on the quality of the risk analysis which establishes reasonable limits for the amount of economic capital that the Bank requires. Management has committed to a thorough review of the risks inherent in the Bank's portfolio, and the results of that analysis (due in 2009) would establish the appropriate levels for the TELR and, by extension, the size of the lending program that the Bank's equity could support.

1.95 In addition to these financial considerations, there are very different governance considerations between the two options. Capital increases are the traditional method by which the Bank expands its lendable resources, and both rating agencies and other financial market participants have come to interpret replenishments as a signal of the continued support of the Bank by its shareholders.

1.96 It is worth noting as well that replenishment discussions in the past have been the focal point for critical discussions among shareholders about the value added by the Bank and the policy objectives it should be pursuing. As noted in the Bank's Institutional Strategy:

> *Periodic capital replenishments have played a key role in the consolidation and development of the IDB. In addition to providing injection of new resources, they provided a negotiating environment among shareholders to agree on priorities, build trust and reach political compromise. Since the goal of a replenishment exercise was to develop a broad consensus and lead to financial commitment, replenishment negotiations provided a democratic environment within which all*

shareholders had an opportunity for effective voice and in the setting of institutional goals and objectives.[24]

1.97 A replenishment of the Bank's capital thus requires the mobilization of commitment on the part of shareholders to both the institution and the Region. Changing policy to rely on economic capital to define lending capacity, on the other hand, requires the mobilization of analytical expertise. The cornerstone of lending limits based on economic capital is the quality of the risk analysis which supports the calculations of required equity. These calculations need to be both technically sound and perceived by the markets as adequate to protect the Bank's bondholders in the event of future negative shocks.

1.98 In assessing the quality of any such risk analysis, the markets are likely to take into consideration a unique feature of the governance of multilateral financial institutions. Virtually all banking institutions that operate on the basis of economic capital also have external regulators who review the bank's capital adequacy on a regular basis. The presence of an external regulator provides additional comfort to the markets that capital adequacy concerns are fully addressed. The IDB has no such regulator, and may thus find it more difficult to persuade markets and rating agencies of the quality of its internal assessment of capital adequacy.

1.99 If the Governors decide in the future that an expansion of lending by the Bank is desired, it may thus be optimal to combine both of the approaches by adopting a capital increase in parallel with a policy change to place more reliance on economic capital in the determination of lending limits. The capital increase both provides evidence of continued shareholder support, and additional callable capital to support the Bank if the risks in the portfolio turn out to be more extensive than originally anticipated.

D. Recommendations

1.100 On the basis of the preceding analysis of lending limits in past lending framework agreements, OVE would make the following recommendations for the construction of a successor agreement.

1.101 **First,** calculations of the Bank's financial capacity should not be used to define near term lending program limits. Instead, they should be used to inform the Governors of the likely future consequences of a proposed lending program. That program should be constructed by analyzing in detail "*borrowers' needs and capacities, the state of the Bank's project pipeline, and the Bank's capacity to prepare good projects" (IDB-8 Agreement).* The calculations of "borrower's needs" should take into account the state of the Region's economic cycle and projections of that cycle for the term of the lending program. The analysis of the pipeline should include all instruments, not merely the three categories of investment, PBL and emergency lending included in the last framework agreement, and should explicitly include non-sovereign lending as a distinct lending category. The Bank's "capacity to prepare

24 GN-2077-1 "*Renewing the commitment to development*" August, 1999. Paragraph 2.16.

good projects" should be demonstrated by reference to development effectiveness standards and protocols that are currently in preparation.

1.102 **Second,** because these calculations are more accurate for the short term, the Board should consider asking Management to define a two-year proposed lending program to cover the period 2009-2010, rather than either the three or four-year programs defined in each of the last two lending frameworks. In addition, the Board might wish to consider making lending program projections dynamic, by adjusting the envelope each year to take account of approvals, disbursements and cancellations experienced in the prior year.

1.103 **Third,** the financial analysis that would accompany Management's estimate of the near-term lending program should indicate clearly whether that program would pose any future challenge to the current lending authority limits. The calculation should not be based on a perpetuity assumption (the same volume of approvals forever), but should instead determine whether that the actually proposed program for the planning period would breach lending authority limits.

1.104 **Fourth,** without regard to whether the proposed lending program challenges current lending authority limits, Board and Management should begin discussions on how to approach the future modification of lending limits when and if such modifications are required by the needs of the Region. As a first step, Management has already indicated a commitment to review the existing methods for measuring the Bank's risk-bearing capacity that are embedded in the current capital adequacy framework. Subsequent steps should include a review of existing lending authority limits as well as the Bank's borrowing policy.

II. PROGRAMMING: IMPROVING WORK WITH THE BORROWING MEMBER COUNTRIES

2.1 A core objective of the NLF was to improve the quality of the Bank's work with the borrowing member countries. The NLF agreement quoted the Bank's Institutional Strategy in recognizing "*country focus as a key principle for maximizing development effectiveness of Bank activities in the Region,*" and sought to "*strengthen country programming to enhance country focus*." The NLF document also contains several references to increasing reliance by the Bank on strengthened country systems for managing the implementation of its program and monitoring the results of that program.

2.2 This chapter will approach the evaluation of this objective of the NLF in three sections: the first dealing with the country strategies actually prepared during the period; the second examining the revised guidelines for country strategy preparation that were approved in 2008; and the third assessing Bank efforts to both strengthen and use country systems.

> ***Recommendation 6:***
> ***Strengthen Country Programming to Enhance Country Focus***
>
> *The programming system should play a key role in deciding the adequate mix of IDB instruments to be utilized by each country, taking into account its development goals, institutional progress, and financial needs. To this end, further efforts should be undertaken to strengthen the country programming process through the review of the Country Strategy Guidelines that the Board of Executive Directors will consider in 2005.*

A. Review of Country Strategies prepared 2005-2008

2.3 There are two fundamental problems in evaluating this recommendation. First, the text is clear that this recommendation is to be implemented through a review of revised Country Strategy Guidelines in 2005, the first year of the NLF period. Management did not produce revised guidelines until 2008, the last year of the period, meaning that there are no actual country strategies that have been prepared in response to this instruction. Second, the language of this instruction is vague and non-specific thus making it difficult to both evaluate and implement the instruction, considering that almost any action could be deemed an attempt "to strengthen" or "to enhance," regardless of the results of the action.

2.4 Despite this lack of clarity, it is possible to find in the NLF document and the Bank's Institutional Strategy some guidance as to what is meant by "enhancing country focus":

> *An important aspect of the new approach to development effectiveness is its emphasis on country ownership of the Country Strategies. Several measures have*

been taken to ensure that the country strategies rely on and support the countries' own priorities, objectives and results.[25]

It is an essential tenet of this report that, instead of attempting to do everything in every country, the IDB should concentrate in doing different things in different countries. In other words, the IDB should substantially increase the country focus of its operations. [26]

2.5 Likewise, one of the central recommendations of RE-300 was that the Bank's strategies with member countries should adopt a programmatic approach, and focus on countries rather than on instruments:

Focus on countries rather than instruments… Country strategies should focus on a strategically-selected, limited range of problems and propose an integrated package of shorter and longer term solutions that provides the highest possible return to the country, without regard to pre-defined notions of appropriate instrument mix.

2.6 Management's response to this recommendation was that the Bank adopt a programmatic approach (NLF recommendation 7).

2.7 In light of this guidance, the "country focus" of Bank strategies can be assessed along three dimensions:

- **Programmatic**. Do the strategies propose a coherent *country program* and do they identify development interventions consistent with diagnosed development challenges?

- **Demand-driven**. Do the strategies identify the government's program, and is the Bank's program consistent with the government's program?

- **Country-specific**. Do the strategies identify country-specific challenges, and are the strategy and the programming consistent with this country specific diagnostic?

2.8 The analysis is based on OVE's evaluability instrument for country strategies, first applied, validated and presented to the Board in 2005. This instrument identifies requirements that jointly define a strategy that is programmatic, consistent, and specific. With respect to demand-driven strategies, the instrument asks questions regarding the identification of government priorities, and the consistency between the Bank's proposal and that articulated by the borrowing government. Regarding country knowledge, the instrument contains questions that assess the presence of sector work, as well as questions regarding how this sector work is used in developing the program. The instrument also contains questions that assess the degree to which strategies are country-specific: Do their diagnostics identify country-specific challenges? Does their proposed program reflect country-specific solutions and risks? Furthermore, the presence of these

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25 GN-2200-13, paragraph 3.49.

26 The Bank's Institutional Strategy GN-2077-1, paragraph 6.22.

components in a concerted and logically coherent manner is the measure by which a strategy is programmatic. Using the existing evaluability instrument has the additional value of allowing comparison of strategies prepared in the NLF period with those prepared earlier.

2.9 **Overall assessment of strategy evaluability**. The 2005-2008 cohort of Country Strategies were assessed by replicating the Office's evaluability method utilized in 2005. The instrument contains seven different standards, each of which is composed of a series of questions to which evaluators rated each strategy. Ratings were on a 1-4 scale, with 1 the lowest and 4 the highest. These scores were normalized to be represented as a percentage of the maximum score. Table 2.1 below presents averages for each of these standards. Each number of the table represents the average rating of questions of the respective standards, as a percentage of the maximum score.

Table 2.1

Evaluability Score as a Percentage of Maximum Score

Standard	Round		Change
	2003-2005	2005-2008	
Logical Consistency	23.57	25.57	2.00
Diagnostic	33.24	43.43	**10.19**
Indicators	14.52	39.18	**24.66**
Monitoring	12.36	17.17	4.81
Objectives	20.13	24.24	4.12
Analysis Programming	14.91	16.92	2.01
Risks	23.03	23.23	0.20
Overall	20.25	27.11	6.86

2.10 **Programmatic.** As can be seen from the table, the overall evaluability of strategies is poor. In general strategies elements are not sufficiently developed, and jointly they do not define a coherent programmatic set of interventions that respond to diagnosed development challenges. Strategies perform poorly in all evaluative standards. Furthermore, collectively strategy elements do not hold together. This is reflected in the persistently low performance in the area of logical consistency.

2.11 In general, CSs do not contain the identification of a strategic program. All CSs identify a loan pipeline as well as a series of non-financial products. However, this collection of projects and activities is not systematically related to the challenges identified, nor are they consistent with strategy objectives. The grouping and organization of these activities is usually based on the Bank's bureaucratic typology of sectors rather than on the development challenges to be addressed. CSs do not contain the content required for the Bank's program with borrowing countries to be country-focused.

2.12 The analysis of each of the dimensions of evaluability illustrates this overall finding. As can be seen from the table, the overall evaluability of strategies is poor. On average, strategies have achieved only 27% of the maximum rating possible. The areas of particular weakness are those relating to the analysis of prior programming (17%), monitoring of the strategy (17%), identification of risks and their respective mitigation measures (23%), objectives (24%), and logical consistency (26%). In these areas most problems identified in the prior evaluability exercise persist in the strategies reviewed.

2.13 In two areas the strategies did relatively better, although there is still clearly room for improvement. These are in the identification of proper diagnostics and in the identification of indicators, so that the strategies may be evaluated in the future. In the first case, on average strategies achieved 40% of the maximum score, and in the second case they achieved 43%.

2.14 A comparison between the two cohorts of strategies reviewed (2003-2005 vs. 2005-2008) shows two areas where strategies prepared in the NLF period show the greatest improvement. In the case of diagnostics, there was a 10 percentage point improvement between the two review periods and in terms of identification of indicators there was a 25 percentage point increase.

2.15 Although strategies showed improvement in diagnostic and in indicators, a comparison between the two cohorts shows little or no improvement in the remaining standards. In dimensions relating to logic, identification of objectives, as well assessment of prior period results, identification of risks, and identification of a monitoring framework for results, reviewed strategies showed little improvement.

2.16 Overall, many of the central findings of OVE's 2005 review can also be applied to the second generation of strategies reviewed. Despite improvements, diagnostics deficiencies persist and diagnostics continue to be inadequately informed by evidence. Likewise, although there is an increase in sector work, the review found that in many cases the Bank has not supplemented information deficits with its own sector work. Diagnostics are also to a large extent inconsistent with the policy proposals by the Bank.

2.17 The review also found continued problems with efforts to review past performance. In most cases CS did not report on the performance, at the level of results, of the Bank's program. Descriptions are by and large limited to a reporting on areas in which the Bank participated or activities that the Bank financed. As was the case with the prior cohort of CSs, there are some examples where the CS reported on prior CS indicators. However, this reporting has been partial, and has not been accompanied with a critical review. This is reflected in the poor rating for this standard, both in absolute terms and in terms of improvements vis-à-vis past strategies. At 17% of the maximum score, it is the standard that preformed worst in OVE's review.

2.18 The problems in the review of past Bank performance are particularly relevant to the Bank's attempt to increase country focus and to be more reactive to country-specific characteristics in programming. It deprives the Bank of a key opportunity to provide both an evidence-based approach to programming and a valuable vehicle for dialogue with country authorities regarding what it can do and what results it can contribute towards.

2.19 Fundamental problems in the intervention logic were also found. Bank activities are still not consistent with either the diagnostic or with the objectives that they purport to support. In many cases, at the sector level, it is unclear what the development challenge is, and even less clear how it is being addressed (by the Bank or other agents). It is also unclear if the Bank's program is consistent with that of the country.

2.20 Although newer strategies contain more indicators, there is little evidence that these indicators do a better substantive job of either defining the key dimensions of a problem, or orienting Bank interventions toward effective solutions. It is relatively rare for goals to have a complete sequence of indicator, baseline value, target value, and milestones to measure progress. Indicators are often generalized descriptions of a sector, and do not provide a level of detail appropriate for the chosen Bank intervention. At other times, the indicators are disconnected from the logic of the chosen intervention model, so that they measure change over time but not changes to the factors presumed responsible for the observed problem.

2.21 Strategies continue to struggle with the treatment of risk. Problems that persist include the inclusion of strategy objectives in the risk section, lack of clarity regarding which strategy objective each risk may affect as well as the magnitude of such impact, and the inadequate identification of mitigation measures. Furthermore, the review also noted the frequent omission from CS documents of risks that turned out to be significant for the subsequent unfolding of the Bank's program.

2.22 The treatment of risk in country strategies also likely reflects a longstanding issue with respect to differentiation among countries. As a cooperative institution, the Bank has a strong preference for treating all countries in the same manner. Risk assessment, however, is inherently an exercise of differentiating one situation from another. The Bank's capital adequacy model discriminates among countries on the basis of financial risk, but the results are aggregated so the individual country risk ratings are not disclosed. Country Strategies, however, are public documents, where a transparent discussion of risk is considerably more difficult.

2.23 Lastly, despite recent efforts to strengthen country systems, (see below) CS monitoring and evaluation systems present the same evaluability problems as those found in prior strategies. These include the lack of an assessment of the current data-generating and reporting capabilities in-country, the lack of a clear identification of responsibilities for generating and tracking results, and the lack of specific action plans to deal with information challenges found. In particular, none of the CSs reviewed presented a plan for migrating toward the use of country systems.

2.24 The review above suggests that there has been no improvement in the logical consistency among strategy components. Country challenges are not derived from diagnostics nor are they informed by a proper review of Bank-supported projects, policies and sector programs. Objectives and challenges are also not adequately related to each other, and the fragmented nature of the development program and activities proposed makes it difficult to discern what strategy the institution is promoting with its corpus of loans and activities. The identification of risks and mitigation measures are also not based on in-country conditions, and in many cases the identification of mitigation measures is wholly inadequate to address the magnitudes of identified risks. Resolving these problems constitute a necessary condition for the development of a country-focused Bank programming.

2.25 Turning to the two remaining areas critical to "country focus": <u>consistency</u> with the objectives of the borrowing government and <u>specificity</u> with respect to sector conditions, the country strategies reviewed exhibit problems in both areas.

2.26 **<u>Consistency</u>**. The assessment of CS documents shows that CSs are consistent with government programs at the level of overall development objectives, but not at the sector level. However, the observed consistency at the overall development goal level is due to the high level of generality of objectives at that level. The review also shows that at sector levels, the operational programs proposed are often not consistent with government programs (or at least this consistency is not demonstrated) nor are they consistent with objectives at that level.

2.27 In many cases the identification of government priorities is too general to be useful. The text below contains the <u>entire</u> statement of country priorities in one recent country strategy.

> "*The country's medium-term course of action under the government program, emphasizes the need to strengthen and modernize the institutional framework in key sectors, focusing on four strategic areas: (i) consolidation of democratic governance; (ii) modernization of the economy; (iii) social and geographic cohesion; and (iv) smart positioning of the country internationally. The priority areas and lines of action target governance, democracy and citizenship, State reform, development of physical infrastructure, gains in productivity and competitiveness, meeting basic needs and reducing poverty, investment in human capacity and security, and environmental sustainability*."

2.28 This statement is so general that it could plausibly be applied to most of the Bank's borrowing member countries. It clearly does not provide sufficient information to determine consistency between the Bank's program and the country's priorities. Lacking a specific identification of public policy priorities to achieve these objectives, the consistency between government and Bank program cannot be established.

2.29 The case of Costa Rica is interesting in that it represents a country in which a frank discussion of the government and Bank priorities is necessary given the difficulties the Bank has had in the past in agreeing on a development program both with GOCR and with civil society. These difficulties are documented in the previous CS with Costa Rica, which mentions that reform initiatives (through a PBL) fell through: "*Despite the government's efforts the required consensuses were not achieved and the reforms lost political viability early on, eliminating the space for the policy-based operations that had been programmed.*"

2.30 Given this context, the central task of the new CS should logically have been to establish the consistency of the proposed program with the country's political economy. Instead, the CS proposes only a tentative program with the country, avoiding the complex discussion of consistency. Critical issues, such as the structure of markets in areas such as energy and roads, and the role of regulation in these sectors are not engaged within the CS.

2.31 In those CS documents that clearly identified government priorities, the review showed that often they are not necessarily consistent with the Bank's proposal. In the case of Uruguay, for example, the government priority did emphasize increases in efficiency of spending, due to fiscal constraints. With little space for programming, the government's efforts, according to the document, are directed at fiscal stability and at increasing the efficiency of the public sector. This context would require the Bank's program to be focused on generating better results from existing programs. This focus on efficiency, however, is missing. Of the lines of action described in the CS (14 described) only four of them include an explicit diagnostic and corresponding policy response that incorporates the issue of quality and efficiency of spending.

2.32 **Specificity.** Enhanced country focus also demands that the Bank be specific as to the nature of problems to be addressed and the results to be expected from Bank intervention. In many cases the review of past strategies found fundamental problems in the consistency between country needs identified in sector diagnostics and the Bank program proposed. In many cases this is due to the absence of diagnostics. However, in other cases a diagnostic is present, but not suggestive of the remedies proposed by the Bank.

2.33 In some cases, such as Haiti, the strategy's interventions do not tackle the country's fundamental development challenges. Despite the overall identification of country-wide civil shocks as the primary deterrent to organizing the state and generating confidence in institutions, the strategy then treats the issue as outside the programming process. Instead of figuring as a fundamental development objective, these challenges are listed in the risk section "*The public's high expectations for rapid improvement in economic and social conditions, the absence of a culture of democracy, organized and well armed criminal gangs, interests tied to drug trafficking and smuggling, and the weakness of the country's security forces all conspire to make the political situation highly vulnerable.*" Instead of seeing a detailed treatment in the diagnostic, it is treated in a superficial way, and in any case is not elevated to the degree of importance that it deserves.

2.34 The case of Panama makes a similar point. Here many of the solutions proposed are not clearly related to the diagnostics, and in many cases do not even contain a corresponding problem statement. In some cases, a problem statement is present, but the policy response is inconsistent with the problem statement. The case of poverty and the State is a good example. Although the strategy identifies poor targeting and efficiency of spending as a possible cause of the slow response of poverty to overall economic growth, the policy response does not tackle either targeting, or spending efficiency.

2.35 The review also found that in many cases the Bank proposes policy solutions that are not consistent with country-specific needs. This is seen, for example, in proposals for vocational training. Country strategies frequently contain language identifying technical or vocational training programs as problems requiring a Bank response. However, they rarely contain diagnostics to justify the policy proposal.

2.36 Lacking these diagnostics, OVE attempted to correlate some commonly available metrics on schooling and unemployment to the presence of a vocational training proposal in a CS. The results of this exercise are presented in Table 2.2 below. *Prima facie*, one would expect CS to address these issues either (i) when it is a pressing issue for youth, such as in the case of high youth unemployment, or (ii) when other issues, such as deficiencies in primary school, have already been addressed. As can be seen, the patterns that emerge are not those expected. That is, it is not the case that these programs tend to emerge where youth unemployment rates are high, or where education metrics of primary and secondary are deficient.

Table 2.2
Vocational Training Metrics

Country	Vocational Training Solution Proposed	Primary Net Enrollment	Secondary Net Enrollment	Youth Unemployment
BA	YES	96	89	20
HA	YES	71	…	…
CH	NO	96	84*	17
CR	NO	…	80	15
CO	YES	88	65	15
DR	YES	77	52	23
ES	YES	94	54	12
JA	NO	90	78	28
PE	YES	96	70	21
PN	YES	98	64	22
UR	NO	95	82*	30
Average Vocational	YES	89	66	15
Average No Vocational	NO	94	81	23

* = estimates based on gross numbers. Source: WDI

2.37 **The anomalous trends.** Although aggregate trends, such as above, can provide stylized data regarding the placement of programs and underlying sector metrics, but in order to learn more about the needs of specific countries and the Bank's response, OVE reviewed the policy proposals in the loan documents corresponding to approved vocational training programs. The results of this review were generally consistent what was found above; that is, the link between country-specific circumstances and policy response is not clear.

2.38 This review suggests that the country strategies prepared in the NLF period do not demonstrate "enhanced country focus" as defined by either improved consistency between the priorities and programs of the government and those of the Bank or enhanced country specificity in the diagnostic basis of programming.

B. The New Country Strategy Guidelines

2.39 Management proposed revised country strategy guidelines in 2008.. Although the Guidelines move away from being programmatic and specific, even as they move toward being more consistent with country programs.

2.40 In terms of being programmatic, the new guidelines have moved away from identifying the means by which objectives are to be achieved, which is the core of a country program. In essence, they do not require the identification of an intervention model.

2.41 According to the Cambridge dictionary, a strategy is "a ***detailed plan*** for achieving success in situations such as war, politics, business, industry or sport," while the IDB's own Institutional Strategy noted that specific Bank strategies should be able to show: "*the connection --or lack of it-- between the actions undertaken pursuant to the strategy and the attainment of its intended goals.*[27] A strategy thus combines both a statement of goals to be attained and an explication of the means to be employed in the pursuit of these goals.

2.42 The new CS Guidelines, however, suggests that Bank strategy documents should include only statements of the goals to be pursued by the Bank in support of country development objectives. Specific actions are not to be in the strategy, but are instead reserved for subsequent programming exercises. The document states:

> "*Through the CS the Bank articulates its intention to support specific country goals (including level of financing), leaving decisions about the content of the operational program (which tends to have a very tentative character at the strategy design stage) to the programming process (paragraph 3.2.)*"

2.43 This decision eliminates any discussion of actual strategy from the document. The detailed work of constructing a real strategy is left to two vaguely defined activities; the "programming process" (see quote above), and the "country business plan." This process is defined in the following fashion:

> *Managing for results will require translating the strategic vision and CS parameters via the programming process into concrete business plans that direct the Bank's resources towards achievement of those objectives which are consistent with the Bank's mandate and institutional priorities (paragraph 2.9)*

2.44 This language creates some ambiguity with respect to the directive role of the country strategy. The country business plans are clearly intended to be more detailed and operational than the country strategy, and it is therefore possible that the business plans could, in effect, supplant the country strategy as the document that actually defines what the Bank intends to accomplish in a country. Given that country strategy documents are approved by the Board on an individual basis and business plans are only reviewed as part of the Budget presentation, there is a potential governance ambiguity in the Guidelines that may need to be reviewed.

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[27] *GN-2077-1, paragraph 5.18.*

2.45 The absence of a clear strategy statement in the Guidelines presents three problems for the institution. First, borrowing member countries do not get from such a document any clear idea how the Bank will add value to their development processes. Stating how much money will flow, and to what sectors, and through what instruments, are not a strategy for maximizing the Bank's contribution. A corollary to this is that absent a definition of strategy activities, only indicators of portfolio efficiency (rather than effectiveness) are identified at the Bank level.

2.46 Second, because the actual strategy to be pursued is not made explicit, there is no opportunity to assess alternative approaches or learn from experience. Better strategies for achieving given objectives cannot be compared with worse ones.

2.47 Third, documents prepared under these guidelines may not be evaluable. The Evaluation Cooperation Group of the Multilateral Development Banks has just approved good practice standards for the conduct of country program and strategy evaluations. (CSPE). One of the foundations for evaluating strategies is the clear discussion of the "intervention logic" involved:

> *A CSPE is premised on the assumption that a series of MDB country strategies and programs can be disaggregated into a contextual diagnosis, strategic and programmatic objectives, and an intervention logic that is amenable to formal evaluation. A typical MDB CSPE exercise begins with an effort to make explicit the causal model implicit in the design of the assistance program.*[28]

2.48 Because the new Guidelines have eliminated the analysis required for specifying at a reasonable level of detail both the causal model that informs the Bank's program and the intervention logic of that program, it is likely that such strategies cannot be meaningfully evaluated. OVE raised this issue during the discussion of the new Guidelines, and indicated that it will need to be confronted again when the Board considers guidelines for future country strategy evaluation.

2.49 As this NLF evaluation was being finalized, Management produced a draft of its proposed "Development Effectiveness Framework," (DEF) which contains specific guidelines for the content of country strategies. The initial draft of this document made proposals that responded to many of OVE's concerns, and contain guidelines that are more in line with ECG standards that those contained in the new CS guidelines approved by the Board in the month of July. OVE notes Management's stated intent to use the DEF standards rather than the CS guidelines in future discussions of strategy formulation and evaluation.

2.50 With respect to consistency, the new Guidelines make it clear that the Bank country strategy must be designed to support the development objectives of the country, as demonstrated from the following language of the Guidelines (emphasis added):

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28 ECG GPS, paragraph 34.

Through the CS the Bank articulates its intention to support *<u>specific country goals.</u>*

In this approach, the CS outlines the expected contribution of Bank portfolio and pipeline *<u>to country goals agreed with the authorities for the period of the strategy</u>*.

The Bank's proposed country program will address a limited selection *<u>from the country's multiple objectives</u>*, *consistent with Bank mandates and priorities*.

2.51 CSGs also clearly recognize the importance of a high quality dialogue informed by analytic work. For example, the CSGs mention:

> *As noted, ESW is considered an integral part of the country program to be implemented throughout the strategy period. A new country administration, however, provides an opportunity to update analytic work in preparation for intensified dialogue and consultation with the country's major political actors and stakeholders.*

2.52 However, one of the fundamental problems of past CSs was the absence of a review of the Bank's program through a self-assessment of development effectiveness. New CSGs do not address this deficiency; on the contrary, they leave the identification of the parameters of their self-assessment as a future exercise:

> *Management's self assessment evaluating actual vs. expected progress towards CS results will be carried out based on a methodology to be developed by VPC in consultation with OVE within six months after the approval of these guidelines.*

2.53 Engaging the client regarding the effectiveness of Bank-supported programs and policies is important not only for a greater consistency between Bank and country programs but also as a way to provide value added in the identification and refinement of good country programs. If the Bank's poor performance regarding the assessment of its development program persists in the future it is unclear how useful the Bank's counsel will be when engaging the country regarding its own development program.

2.54 With respect to <u>specificity</u> the new Guidelines eliminate much of the detailed work called for in the old guidelines, particularly with respect to country diagnostic work. The changes can be seen clearly by comparing the old guidelines with the new ones on the subject of the specific diagnostic and analytical work required for a country strategy:

Box 2.1

Comparison of Old Country Strategy Guidelines with New

Old Guidelines	New Guidelines
Should contain a concise statement of the situation in the country with regard to the Bank's two over-arching priority areas, namely, **poverty reduction**, and **sustainable development**. With regard to the former, the section should summarize the nature and extent of poverty in the country, and should contain a table of relevant social indices as well. In this context, the Bank will take immediate steps to strengthen its analytical work, in accordance with paragraph 2.11 and the IDB-8 Agreement, to ensure the full integration of poverty reduction and social equity issues within CP's. The strategy is designed on the basis of an analysis of the Bank's experience in the country, the government's development program and commitments to Millennium Development Goals, the assistance strategies of other external development agencies, and the Bank's estimation of its areas of comparative advantage. This process leads to the development of criteria for the identification of specific lines of activity for the Bank in the country.	This updating of country knowledge might include analysis of: (i) Bank experience and lessons learned in helping to address constraints to key country development objectives, including review of strategic approach and formulation of targets; (ii) persistent, changing or new constraints, including those related to the business climate and private sector development; (iii) experience of other development partners; and (iv) new issues raised in ongoing country dialogue.

2.55 Not only are the new Guidelines less directive ("might include" vs. "should contain") they also do not demand that the Bank construct a proposed country strategy on the basis of specific analysis of issues of central importance to the Bank's mission. For example, the new Guidelines contain no references whatsoever to concepts like "poverty" "sustainable development" or the "Millennium Development Goals."

2.56 In contrast, Box 2.2 contains the analytical requirements for World Bank Country Assistance Strategies, which do embody greater specificity than either the old or the new country strategy guidelines of the IDB.

Box 2.2.: World Bank County Assistance Strategy (CAS) Guidelines
CAS diagnosis typically covers the following topics:

- **Poverty.** A sound diagnosis of the incidence, trends, and causes of poverty, including the major obstacles to poverty reduction and the set of structural and social elements essential to poverty reduction; a discussion of progress (or lack thereof) in poverty reduction since the last strategy; an analysis of the linkages between poverty reduction and the level and pattern of growth in the country; and an assessment of the country's capacity to monitor poverty indicators. This discussion is based on a poverty assessment or other available poverty analysis.

- **Sociopolitical and Institutional Factors.** A discussion of the social, political economy, and institutional factors—including any need for capacity building—that affects the country situation and the Bank Group's strategy.

- **Macroeconomic Framework.** The CAS includes a thorough analysis of country macroeconomic and structural performance and policies. It mentions the status of the IMF relationship and, as relevant the IMF program, and discusses the division of labor between the Bank and Fund.

- **Debt Sustainability.** All CASs include a discussion of debt sustainability, including a detailed debt sustainability annex when necessary. In countries where debt sustainability is not an issue, this should be noted explicitly.

- **External Environment.** A discussion of the external environment, underlining any relevant issues related to trade and/or regional integration, and its effects on the country's economic performance.

- **Governance.** A careful diagnosis of governance conditions, including corruption and public financial accountability issues, their impact on the country strategy, and the risks they pose to Bank Group activities.

- **Private Sector Development.** An analysis of the major obstacles to and Bank Group activities aimed at strengthening private sector development. The level of IFC and MIGA involvement in CAS preparation should be according to the joint category of the CAS.

Other Cross-cutting Issues. A diagnosis of other cross-cutting issues as relevant to the country—e.g., education, gender, health, nutrition, and population, infrastructure, energy, environment, financial sector—drawing on available analysis.

2.57 Another change related to reduced specificity is that while the old guidelines called for a detailed review of the results achieved by the previous strategy, the new guidelines state that the issue of reviewing past performance has not been resolved, and promises to work with OVE to develop something in this area within 6 months of approval.

2.58 Specificity is also reduced with respect to country financing. The sentence in the guidelines specifying the financial envelope for sovereign guaranteed operations provides three separate qualifiers, each acting to reduce the required specificity. The Guidelines state that:

> *The CS specifies the overall level of new financial resources that the Bank could channel to the country during the strategy period; in some cases, establishing base case and other scenarios and respective triggers, if applicable. (Paragraph 4.10), (emphasis added).*

2.59 One of the results of the reduced specificity demanded by the new Guidelines is that future country strategies may well not contain actual, evaluable, strategies for addressing country needs.

C. Utilization and Strengthening of Country Systems

2.60 Under the heading of "Country Ownership and Capacity Strengthening," the NLF background document articulated the importance of country systems:

> *The need to strengthen public sector capacity in borrowing countries is an integral part of these developments. Countries must take a stronger role in the design, implementation and evaluation of their own development programs. Improvements in public sector management for results will place borrowing countries in a more advantageous position to secure increased flexibility in lending and to reduce transaction costs, as a result of the adoption of a programmatic approach.*[29]

2.61 And in the section dealing with "adopting a programmatic approach," the following language appears:

> *"This approach should be based on rigorous economic and sector analysis and move in a direction of greater reliance on country systems with respect to budget allocation, program and project design, procurement, monitoring and evaluation*." (Par. 4.40)

2.62 To make operational this recommendation, the Bank established in March 2005 the Program to Implement the External Pillar of the MTAP for Development Effectiveness (PRODEV). The objective of PRODEV was:

> *"To strengthen the capacity of borrowing member countries to manage for results throughout the public sector, and become more effective in the use of all resources, including those provided by the Bank."*

2.63 PRODEV was to contribute to improving this situation by delivering two specific types of value to countries:

> *"(i) assist countries in specific areas of public administration envisioned within the concept of certification, which in turn will progressively allow for increased lending under the new flexible Bank instruments;*
>
> *(ii) act as the integrating factor and alignment vehicle, via the regular Bank programming process, of all other efforts carried out by the IDB group in order to support the establishment of effective and results-driven public sectors in our borrowing member countries."*[30]

2.64 It is important to note that in both documents, the emphasis is on enhancing the capacity of countries to manage for results. To evaluate progress, this section will look first at the attention paid to utilization and strengthening of country systems for results management in the Bank's programming documents, and will then examine the work of PRODEV in implementing this agenda in the Region.

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[29] GN-2200-13, paragraph 3.50.

[30] GN-2346-1. Page 2, paragraph 7

2.65 The treatment of PRODEV in this section will focus on its integration with other tools for improving country programming. The specific accomplishments of PRODEV in actually improving country capacity to manage for results are discussed in Chapter V on Development Effectiveness.

2.66 **Country Systems in Country Programming Documents.** An analysis of the country programming documents prepared since the adoption of the NLF in 1995 shows relatively little emphasis on country systems in formal programming. The Tables below show four types of country systems:

- Procurement and Financial Accountability
- Investment Planning and Prioritization
- Budgeting
- Statistics, monitoring and evaluation

2.67 With respect to each of these systems, the review asked four questions: (i) is there a problem statement (PS) regarding what works and what does not work in country systems? (ii) is there an evidence-based diagnostic? (EBD) (iii) is there a plan for the Bank to migrate toward country systems?, and (iv) is there an identification of existing systems through which the Bank can execute (Executive)?

Table 2.3a
Country Systems in Country Strategies:
Procurement and Investment Planning

	Procurement and Financial Accountability				**Investment Planning and Prioritization**			
	PS	*EBD*	*Plan*	*Executive*	*PS*	*EBD*	*Plan*	*Executive*
BA	Yes	Yes	No	No	No	No	No	No
HA	Yes	Yes	Yes	No	No	No	No	No
JA	Yes	Yes	No	No	No	No	No	No
PE	Yes	Yes	No	No	No	No	No	No
PN	No	No	No	No	Yes	No	No	No
UR	Yes	Yes	No	No	No	No	No	No
CH	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
CO	Yes	Yes	No	Pilot	No	No	No	No
CR	Yes	Yes	Yes	No	No	No	No	No
DR	Yes	Yes	No	No	No	No	No	No
ES	Yes	Yes	No	No	No	No	No	No

PS - Problem Statement
EBD - Evidence-based diagnostic (usu CFAA/CPAR, in some cases PER)
Plan - Is there a plan to move toward country systems
Executive - Does the CS identify which systems the Bank can and cannot use and under what circumstances.

Table 2.3b
Country Systems in Country Strategies
Budgeting and Monitoring

	Budgeting process				Statistics, Monitoring and Evaluation			
	PS	*EBD*	*Plan*	*Executive*	*PS*	*EBD*	*Plan*	*Executive*
BA	Limited	No	No	No	No	No	No	No
HA	No	No	No	No	No	No	No	No
JA	No	No	No	No	No	No	No	No
PE	Yes	Yes	No	No	No	No	No	No
PN	No	No	No	No	Yes	No	No	No
UR	Yes	Yes	Limited	No	No	No	No	No
CH	No	No	No	No	Yes	Yes	Yes	No
CO	Yes	No	No	No	No	No	No	No
CR	No	No	No	No	No	No	No	No
DR	No	No	No	No	No	No	No	No
ES	No	No	No	No	No	No	No	No

PS - Problem Statement
EBD - Evidence-based diagnostic (usu CFAA/CPAR, in some cases PER)
Plan - Is there a plan to move toward country systems
Executive - Does the CS identify which systems the Bank can and cannot use and under what circumstances.

2.68 The tables show much more attention to issues of procurement and financial accountability than to issues of investment planning, budgeting and monitoring. With the exception of Panama, all strategies at least mention the country's status regarding procurement and financial accountability. In most instances this is the result of the preparation of a CFAA or CPAR assessments financed jointly with the World Bank. In all cases where there is a problem statement, there is also a reporting on the findings of the respective sector work.

2.69 Although CSs report on procurement and financial accountability, in most cases they do not present a plan for utilizing country systems nor do they report on executive decisions already taken to use them. In other words, the CS does not make full use of sector work related to procurement and financial management in developing corporate plans to utilize country systems. The exceptions are Chile, and to some extent Colombia, Costa Rica and Haiti.

2.70 In Chile the CS is explicit in the use of both procurement and auditing functions. It also contains a plan to gradually use national investment prioritization systems and national evaluation systems (in order to provide PPMRs with evidence on program effectiveness). In Colombia the CS identifies that on a pilot basis the Bank is already using information technology systems on financial management. In Haiti the CS identifies problems in procurement and presents a plan not to use country systems given the deficiencies identified, but to operate by exception with an ad hoc set of procedures.

2.71 Only in two cases (Chile and Panama) do country strategies address the use of country systems for investment planning, and only in the Chile case does the country strategy contain a diagnostic and an action plan. In budgeting, there is some discussion in CSs regarding results-based budgeting –mainly in Peru, Uruguay and Colombia. Interestingly, the country with the most advanced results-based budgeting systems, Chile, does not have a CS that details the system's characteristics. In any case, only in the case of the Uruguay CS is there some consideration of altering the programming in function of the Government's five-year budget plan, but even in this case, the details of how this will be done are not given.

2.72 Bank CSs have not identified the use of CS in monitoring and Evaluation. There are no cases in which the Bank reports using country systems, and only one case in which there is mention of moving in this direction, the case of Chile. There are only two cases in which the strategies contain problem statements regarding the extent and quality of country tracking systems, and only one instance in which results of a diagnostic are presented.

2.73 This last finding is of particular concern in light of the emphasis placed in the NLF and the Bank's subsequent Realignment document on the importance of Managing for Development Results (MfDR). Given the high level of generality in Bank country strategy documents, it is possible that progress in this area is more substantial than would be indicated from the review of country strategies alone. In fact, the Bank launched a specific technical cooperation initiative, PRODEV, at approximately the same time as the approval of the NLF, with the specific objective of strengthening country systems for results management. While it is premature to evaluate PRODEV at this point, Chapter 5 of this evaluation will look at the preliminary contributions PRODEV has made to strengthening country capacity to manage for development results.

D. Recommendations

2.74 Given the importance of "country focus" for the Bank, it is essential that the quality of country programming be improved. This requires both increased clarity on the meaning of country focus and internal guidelines and procedures that generate improved country focus in the Bank's programming efforts. Specifically, OVE recommends:

- **First,** a reconsideration of the recently-approved Country Strategy Guidelines in light of the new ECG good practice standards for country strategy Evaluations. This is contemplated in Management's new Development Effectiveness Framework.
- **Second,** Country Strategy documents should have a robust framework for the results anticipated from the program. This would need to be built upon detailed sectoral diagnostic work, and an evidence-based review by Management of results achieved under the previous strategy.
- **Third,** Country Strategy documents should be subject to quality review for the three dimensions of consistency, specificity and evaluability discussed

above. Results of these quality reviews should accompany CS documents through the approval process.

- **Fourth,** the role of the Country Strategy with respect to country business plans needs to be clarified. Having different documents with different level of specificity and different approval mechanisms is an obstacle to clear accountability.
- **Fifth,** the analysis of risks to the implementation of the CS and to the achievement of future results needs to be substantially deepened. The current expanded treatment of project risk might also be applied to assessing and mitigating the risks at the country strategy level.

III. BANK INSTRUMENTS

3.1 The Bank's primary business is the making of loans to support the economic and social development of the borrowing member countries. Over time, a differentiated set of rules has evolved regarding how proposals are processed, what information they must contain, what activities they can support, how they are disbursed, what fiduciary safeguards they contain, and how they are evaluated. These rules are entirely a creation of the Bank. Some are dictated by decisions of the Governors or Executive Directors, others are determined by Management. "Instruments" is a term usually used to refer to particular combinations of rules that define different types of loans. To be defined as an "instrument" means that all loans of a given type have similar rules and are tracked separately in the Bank's database.

3.2 Several sections of the NLF make recommendations regarding the characteristics and use of different Bank instruments. The higher level instrument groupings (investment, PBL and emergency) were partially addressed in Chapter 1. This Chapter will look at Recommendation 4 (making investment loans more flexible); and Recommendation 7 (adopt a programmatic approach). It will also observe compliance with Recommendation 3, (continue to make PBL loans from FSO resources).

A. Bank Lending Instruments

3.3 As background for the 2005-2008 NLF, OVE undertook a comprehensive review of the Bank's instruments (RE-300). That analysis found that the Bank had two broad "families" of instruments: those financing specific expenditures, and those financing the countries generally, without reference to specific expenditures. Specific expenditures tended to be financed with "investment" loans, while general finance tended to be provided by both PBL and emergency loans. Over time, however, the distinction among families has become less clear.

3.4 RE-300 also found that both the IDB and the World Bank were experiencing a common set of complaints regarding their lending instruments: demand for traditional investment project lending was falling; borrowers were concerned about the high transaction costs of dealing with the institutions, and fiscal constraints limited country capacity to borrow. The report noted:

> *In responding to these new challenges, both institutions have had to struggle with two basic alternative approaches to instrument reform: proliferation or simplification. Faced with constraints inherent in existing instruments, the institutions can either create new instruments with fewer, different or better constraints, or reduce the number of instruments and allow more latitude as to what can be done within each instrument. The proliferation approach assumes it is possible to design new instruments appropriately matched to country needs, while the simplification approach regards pre-defined instruments as a hindrance to problem solving.*[31]

[31] RE-300 "Instruments and Development," paragraph 7.3.

3.5 RE-300 recommended that the Bank adopt the simplification approach, connecting to country needs through an improved programming approach rather than through the proliferation of instruments:

> *In light of a strengthened country programming process, the Board of Executive Directors should consider a significant simplification of the Bank's instrument mix. Since both policy reform and specific investments are components of effective programmatic approaches, both should be financeable with the same instrument, thus ending the distinction between investment loans and sector/PBL loans.*

3.6 This recommendation was discussed in Management's proposal for the 2005-08 lending framework. The discussion recognized the validity of some of the points made, but concluded that it was too soon to recommend the proposed radical simplification of instruments. The document stated:

> *Although Management believes that it is still necessary to preserve the two regular lending categories, over time, the increased flexibility given to investment lending through the recently approved PDL, the SWAP and the review of the policy on expenditure eligibility currently under Board consideration, would move the Bank in that direction.*

3.7 This recommendation, which was accepted by the Governors, indicated interest in the programmatic approach recommended by RE-300, but intended to pursue this objective through "increased flexibility given to investment lending" through both generic changes to Bank rules, and the use of specific new lending instruments. The NLF also contained a recommendation to "adopt a programmatic approach."

3.8 The decision to maintain the existing lending categories meant that the Bank operated through the NLF period with the large and diverse mix of 21 specific instruments shown in Table 3.1. The left panel shows the instruments (and their identifying codes) used from 2000 to 2004, while the right panel shows the instruments and codes in use during the NLF period. Most of the instruments are unchanged from the prior period, although several code changes were adopted, which makes tracking instrument use over time more difficult. The most significant change in approvals, however, relates to the expanded use of direct lending to the private sector, a lending instrument that was not included in the NLF proposal and therefore is not covered in this evaluation.

Table 3.1
Bank Lending Instruments

Loans Approved 2000-2004			
Code	Type	Approved	Rank by total
ESP	Specific Investment	9,300	1
PBL	Policy Based Loan	8,147	2
EME	Financial Emergency Operation	3,880	3
PFM	Multi-Phase Lending Project	3,239	4
PSL	Private Sector Loan	1,889	5
GCR	Global Credit Operation	1,717	6
CLP	Project Using a CCLIP	1,000	7
GOM	Global of Multiple Works Operation	614	8
INO	Innovation Operation	176	9
ERF	Immediate Response Facility for Emergencies	119	10
SEF	Sector Facility	93	11
TCR	Technical Cooperation Loan	87	12
MIF	MIF Multilateral Investment Fund	59	13
SMP	SEP & Small Project	42	14
PEF	Project Preparation & Execution Facility	34	15
PDL	Performance Driven Loan	30	16
HIB	Hybrid Operation	28	17
SUP	Supplementary Financing	27	18
GPR	Global Pre-Investment Operation	12	19
GDL	Guarantee Disbursement Loans	0	20

Loans Approved 2005-July, 2008			
Code	Type	Approved	Rank by total (Rank in 2000-04)
ESP	Specific Investment	6,592	1 (1)
PSL	Private Sector Loan	4,808	2 (5)
PFM	Multi-Phase Lending Project	3,846	3 (4)
CLP	Project Using a CCLIP	3,000	4 (7)
PBP	Programmatic Policy Base Loan	2,350	5 (new)
GOM	Global of Multiple Works Operation	2,341	6 (8)
PBL	Policy Based Loan	1,775	7 (2)
PDL	Performance Driven Loan	515	8 (16)
SUP	Supplementary Financing	190	9 (18)
SEF	Sector Facility	114	10 (11)
MIF	MIF Multilateral Investment Fund	91	11 (13)
GCR	Global Credit Operation	89	12 (6)
GDL	Guarantee Disbursement Loans	60	13 (20)
HIB	Hybrid Operation	52	14 (17)
INO	Innovation Operation	50	15 (9)
ERF	Immediate Response Facility for Emergencies	47	16 (10)
PEF	Project Preparation & Execution Facility	36	17 (15)
SMP	SEP & Small Project	30	18 (14)
OMJ	Opportunities for the Majority	25	19 (new)
TCR	Technical Cooperation Loan	21	20 (12)
EME	Financial Emergency Operation	0	21 (3)
GCR	Global Credit Operation	0	22 (6)
GPR	Global Pre-Investment Operation	0	23 (19)

3.9 The NLF also expressed concern regarding the use of different Bank instruments with different funding sources. Recommendation 3 directed the Bank to "***Continue to finance policy-based loans out of FSO resources for FSO-eligible countries***." Table 3.2 shows the various Bank instruments and the approvals made over the NLF period from both OC and FSO resources. The table shows that FSO countries did continue to receive policy based lending, but in somewhat smaller volumes and in different forms from PBL operations financed with OC.

Table 3.2
Approvals by Instrument Type and Funding Source
January 2005-June 2008

Type of Operation	FSO	ORC	FSO	ORC
	Value of Approvals		Share of Total	
Specific Investment Operation	677,365,000	5,424,243,000	61.44%	22.46%
Private Sector Loan		4,808,360,000	0.00%	19.91%
Multi-Phase Lending Project		3,771,090,000	0.00%	15.62%
CCLIP		3,000,000,000	0.00%	12.42%
Global of Multiple Works Operation	20,000,000	2,300,385,700	1.81%	9.53%
Programmatic Policy Base Loan	15,000,000	2,210,000,000	1.36%	9.15%
Policy Based Loan	137,900,000	1,625,000,000	12.51%	6.73%
Performance Driven Loan	31,600,000	438,500,000	2.87%	1.82%
Supplementary Financing	30,000,000	117,000,000	2.72%	0.48%
Sector Facility	15,000,000	99,041,100	1.36%	0.41%
Guarantee Disbursement Loans		60,000,000	0.00%	0.25%
Emergency Response Facility		46,700,000	0.00%	0.19%
Global Credit Operation		39,100,000	0.00%	0.16%
Project Preparation & Execution Facility	1,963,000	33,912,750	0.18%	0.14%
Innovation Operation	20,000,000	30,000,000	1.81%	0.12%
Regional Public Goods		28,630,000	0.00%	0.12%
Opportunities for the Majority		25,000,000	0.00%	0.10%
Technical Cooperation Loan		21,414,500	0.00%	0.09%
PRODEV		20,532,300	0.00%	0.09%
Regional Infrastructure Integration		16,134,520	0.00%	0.07%
Infrastructure Project Preparation Fund		16,008,240	0.00%	0.07%
Social Fund		5,800,000	0.00%	0.02%
SECCI		5,224,520	0.00%	0.02%
Technical Cooperation Emergency	1,000,000	4,560,000	0.09%	0.02%
Fund for Financing of Disaster Prevention		2,700,000	0.00%	0.01%
Hybrid Operation	51,650,000		4.68%	0.00%
Regular TC	79,046,620		7.17%	0.00%
SEP & Small Project	21,172,000		1.92%	0.00%
TC - CT/Intra	764,469		0.07%	0.00%
TOTAL		24,149,336,630	100.00%	100.00%

3.10 Traditional PBL operations accounted for 12.5% of the FSO approvals, as compared with 6.7% of OC approvals. However, the FSO saw only very few "programmatic" PBL operations (1.6 vs. 9.1% for OC). Thus OC borrowers financed 16% of their program with PBL operations, as against 14.1% for FSO.

3.11 It is also interesting to note from the Chart that the Bank's new flexible, innovative and programmatic lending types were generally not financed with FSO resources. The exceptions are performance-driven loans, which have actually constituted a larger share of approvals from FSO resources than from the OC. The complete absence of private sector lending financed with FSO is due to Governor's decisions to confine that line of activity to the OC alone.

3.12 Against this background, the principal instruction of the NLF related to investment lending was:

Recommendation 4

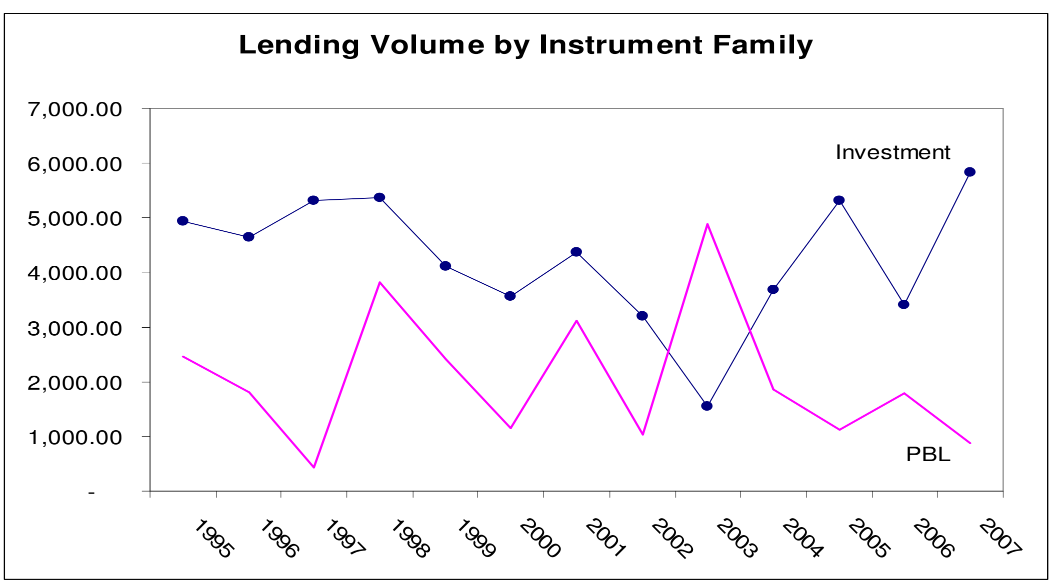
Make investment loans more flexible

Measures should be taken towards adopting more flexible policies and procedures for investment loans in order to make them more attractive when compared with PBLs, and towards eliminating an implicit bias that favors PBLs.

3.13 At the time this recommendation was written, demand for investment lending at the Bank had fallen precipitously, and there was a concern that countries were becoming only interested in PBL operations. This situation has changed considerably over the NLF period.

3.14 Figure 3.1 compares lending to the public sector by the two main instrument "families": investment and PBL. It shows a precipitous decline in investment lending from 2001 to 2003, and a corresponding rise in PBL (including emergency PBL). It was this experience that formed the background for the 2004 discussions on the NLF. The trends reversed sharply beginning in 2005, with the result that the more recent data show no "implicit bias" in favor of PBL operations.

Figure 3.1



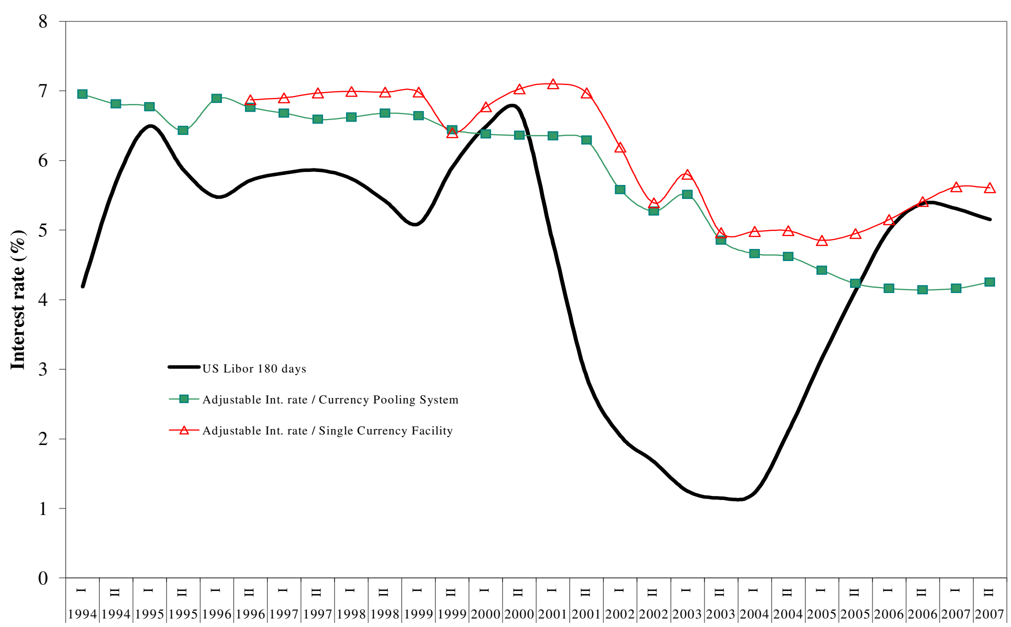
3.15 Before moving to specific changes that were made to the investment lending instrument, it is important to note that two factors external to the Bank may account for the pattern shown in Figure 3.1.

3.16 First, the NLF period was one of extraordinarily positive macroeconomic conditions in the Region. Most economies grew, some strongly, and public finances improved virtually across the board. The need for the kind of fiscal support provided by PBL operations may have simply not been needed during this period. Conversely, as macro conditions improved, countries could have been in a better situation to undertake investment projects.

3.17 A second macro issue that could have affected demand for Bank products is the competitiveness of its interest rates. Before 2003, the Bank offered loans under a Currency Pooling System (CPS) established in 1982. This system was replaced in 1996 by an adjustable Single Currency Facility (SCF) to reflect the cost of the pool of borrowings allocated to such loans. Between 1994 and 2000, CPS and SCF rates were around 100 basis points greater than the 180d-Libor. However, this differential started growing after the second semester of 2001. The spread increased to almost 500 basis points by the second semester of 2003. The increasing spread coincides with the reduction in the Bank's investment loan approvals, and the narrowing of spreads coincides with recovery of investment lending. (Figure 3.2). During the period of widening spreads, countries may simply have found it more attractive to finance public investment projects in the market while taking into account the changes in specific project conditions mentioned in paragraph 3.57 below. As LIBOR rose after 2003, the Bank became more competitive in the market, a change that coincides neatly with the resumed growth of investment lending.

Figure 3.2

IDB Interest Rates and Libor



3.18 In terms of specific changes made to investment lending, there were fundamentally two different approaches taken. The first dealt with changes to Bank procedures generally, while the second dealt with the use of specific investment "instruments" that were thought to provide more "flexibility" for the borrowing countries.

3.19 A number of the general changes were explicitly spelled out in the NLF document, which made the following specific recommendations:

- *the elimination of the "matrix" of foreign exchange financing;*
- *adjustment to current policies on eligibility of expenditures to bring them in harmony with other MDBs;*
- *flexibility of requirements on procurement, hiring, audited financial reports and external auditing;*
- *setting amortization periods for investment loans of up to 25 years and for PBLs of up to 20 years;*
- *allowing for the possibility of providing midstream financing to on-going projects.*

3.20 **Matrix and Eligible Expenditures**. Elimination of the matrix of foreign exchange financing, and the removal of restrictions on eligible expenditures had been approved by the Board of Executive Directors in November of 2004, prior to the approval of the NLF itself. The new proposals dropped the requirement for a specific level of counterpart funding in projects, and allowed countries to demonstrate their commitment to, and "ownership" of, the projects in was other than a specific commitment of financial resources. They also substantially broadened eligibility for financing such items as taxes and fees, recurrent expenditures, working capital, land, commercial buildings, and transitory expenditures such as the payment of indemnifications. In doing so, they brought IDB practice in line with that of the World Bank, thus eliminating a potential area of competition between the two development finance institutions.

3.21 Although it approved the changes, the Board had two specific concerns with respect to the new approach, as outlined in the Report of the Chair of the Policy and Evaluation Committee that recommended approval of the changes:

> *On a conceptual level, the concerns expressed by Directors were largely concentrated on two issues: the advisability of financing recurrent expenditures with debt and the role of counterpart funding to ensure ownership of projects supported by Bank financing.*

3.22 Management also recognized the validity of these concerns, and proposed a number of safeguards to guard against their occurrence. Management argued:

> *This proposal does not seek to allow indiscriminate financing of expenditures, which would lower project quality, or to provide financing that exceeds the fiscal and debt carrying capacities of borrowing member countries. It acknowledges the risk of poor implementation of this new policy framework, and proposes a series of measures to mitigate potential risks. As a consequence of the new policy, both eligibility of expenditures and the Bank's share in financing the total project cost will be adjusted in keeping with the economic conditions of each*

borrowing member country. Country commitment to its development program will be determined by public spending, how it is funded, and other factors. Instituting this new country focus will require: (a) weighing government ownership of its overall development program through its contribution to funding it, especially the sector to which the Bank resources are to go; (b) consideration of the borrowing capacity and taxation system of each borrowing country; and (c) agreement on loan terms with the authorities of each borrowing country. A major challenge of the new policy will be to strengthen the Bank's mechanisms for effective quality control of country programming and analysis, and to train staff[32].

3.23 The new rules were to be applied on a country-by-country basis, establishing "Country Financing Parameters" for each borrowing member country. Thus to guard against the "indiscriminate financing of expenditures," Management proposed an analytical process designed, in fact, to discriminate between countries on the basis of their ability to prudently manage both the debt associated with recurrent cost financing, and the commitment that had formerly been ensured by counterpart requirements. As an additional safeguard, Management promised three types of reporting to the Board: 1) an annual progress report; 2) twice-yearly reports on recurrent cost financing; and 3) an evaluation of the changes after three years of implementation.

3.24 The four required semi-annual reports called for by the new policy were not produced, and the overall evaluation has also not yet materialized. Only one progress report was submitted by Management (in 2006), and it contained the following table showing how the results of the CFP process in each country had established whether a general limit on recurrent cost financing should be applied.

Table 3.3

Parameters for recurrent cost financing: General limit

Region 1		Region 2		Region 3	
Country	**CFPs**	**Country**	**CFPs**	**Country**	**CFPs**
Argentina	No limit	Belize (*)	No limit, but with decreasing contributions	Bahamas	No limit
Bolivia	No limit	Costa Rica (**)	N/A	Barbados	No limit
Brazil (*)	N/A	Guatemala	No limit	Colombia	No limit
Chile	No limit	Haiti	No limit	Ecuador[5]	No limit
Paraguay	No limit	Honduras	No limit	Guyana	No limit
Uruguay	No limit	El Salvador	No limit	Jamaica	No limit
		Mexico	No limit	Peru[6]	Not financed
		Nicaragua	No limit	Suriname (**)	N/A
		Panama	No limit	Venezuela[7]	Not financed
		Dominican Republic	No limit	Trinidad & Tobago[8]	Not financed

(*) Have CFPs that were approved after 30 June 2006.

(**) CFPs in the process of final consultation with the authorities.

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5. Except for the restrictions on public borrowing set out in article 9 of the Fiscal Accountability, Stabilization and Transparency Act (LORETF) and its Regulations (Article 24).

32 GN-2331-5. Paragraph 3.39.

6 Peru's Constitution limits the external financing of permanent recurrent costs.
7 Venezuela's legislation does not permit recurrent costs to be financed with foreign debt.
8 The Government of Trinidad and Tobago has asked that financing be limited exclusively to investment.

3.25 According to the Guidelines established by Management: "CFPs are based on an assessment of a country's macroeconomic conditions, the quality of its fiscal and debt management, its development program, and the quality of its budget management and fiscal regime."[33] By this standard, CFPs are designed to discriminate among countries, yet no discrimination is evident from the table. In fact, the old system which the new guidelines replaced actually did discriminate among country groups, by setting different financing percentages for each group. Under the new policy, however, all countries were deemed eligible for "no limit" on recurrent cost financing with IDB debt unless their laws or constitutions prohibited the practice.

3.26 Management also made a commitment to produce an overall evaluation of these changes three years after approval. This evaluation has not been completed, but it would include:

> *…technical, financial, and economic analysis (cost-benefit or cost-efficiency, depending on the sector) of each project submitted to the Board of Executive Directors for consideration and approval. Outcomes will also have to be evaluated. An assessment of the new policy's implementation will be submitted to the Board of Executive Directors three years after it enters into effect, and would include, among other things, a review of the list of eligible expenditures and their impact on achieving the development objectives, insofar as their impact can be ascertained early from an evaluation of progress in project execution.*[34]

3.27 It is useful to note that this strong commitment to cost-benefit or cost-efficiency analysis at the project level was made two months after both Management and the Board reviewed the findings of RE-300 that found such analysis absent or inadequately documented in the vast majority of Bank projects.

3.28 In addition to recurrent cost financing, the changes approved also broadened substantially the kinds of expenditures that could be financed with IDB resources. Again, Management promised to make a discriminating assessment of country realities before implementation, stating:

> *…both eligibility of expenditures and the Bank's share in financing the total project cost will be adjusted in keeping with the economic conditions of each borrowing member country.*

3.29 No specific guidance as to how these country assessments would be done was provided in the initial policy proposal, and no subsequent guidelines have been established. OVE was unable to determine whether such country-by-country assessments have been undertaken to determine which expenditures would be eligible, and so the most likely situation is that no country-level analysis has been

[33] GN-2331-11, "Guidelines for the eligibility of expenditures in investment loans." Paragraph 2.4.
[34] GN-2331-5 "Modernization of policies and practices that restrict the use of resources in investment loans. Final version, Paragraph 3.41.

conducted, and all countries are eligible for the expanded menu of expenditures listed in the policy document.

3.30 From this analysis, it would appear that for the key issues of recurrent cost financing, counterpart requirements, and eligible expenditures, the 2004 changes were implemented across the board, representing a substantial relaxation of previous rules governing investment loans financing specific expenditures. This represents a significant and substantial increase in the "flexibility" of investment lending instruments.

3.31 In addition to these changes, the Bank in 2004 modified its policy on financing cost-overruns in investment projects. (GN-2329). The prior policy, approved in 1977, did not have formal procedures established and had been applied to only a single project since its approval. Management justified the policy change as part of the flexibilization and results agenda, noting:

> *Another reason for the proposed expansion of coverage is that the Bank has created an array of new financing facilities since the present policy was approved, reflecting the institution's commitment to project objectives more than to the components and costs identified during the design phase.*

3.32 As Table 3.4 demonstrates, since 2004 this new way of financing cost overruns has been used 5 times, exclusively for large infrastructure projects, and has allowed the Bank to increase funding from between 24 and 216%.

Table 3.4
Supplemental Financing

				Original Loan		
Number	**Name**	**Year**	**Amount**	**Year**	**Amount**	**Change**
BH-L1024	Supplementary Financing for New Providence Transport Program	2008	100	2001	46.2	216%
HA-L1021	Supplemental Financing for the Agricultural Intensification Program	2007	12.5	2003	41.9	30%
HO0174	Supplemental Water Supply and Sanitation Investment Program	2006	30	1999	26	115%
HO-L1020	Supplemental Financing Improvement PPP Atlantic Corridor	2007	30	2004	50	60%
PN-L1017	Supplementary Financing Prog. Sust. Dev. Darien	2007	17	1998	70	24%

3.33 **Other General Procedural Changes.** While changing the matrix and expanding eligible expenditures and allowing supplemental financing were done through an explicit policy change approved by the Board, other changes in how the Bank deals with investment loans were also undertaken. Management adopted in 1999 a series of measures designed to reduce the procedural delays in loan processing. These included reducing the number of review committees, simplifying required documentation, and reducing the detail required for the profile stages of projects.[35] In individual loans and individual countries, restrictions on requirements related to procurement and audited financial statements have been relaxed. The thresholds below which local procurement systems can be used have been raised, permitting a larger portion of total procurement to be managed through local procurement systems. Four countries have had their electronic procurement systems "certified" for use in IDB loans, and other countries are being considered for the same treatment. Amortization schedules have been extended, as recommended in the NLF.

3.34 Perhaps the most significant generalized change has related to how the Bank reviews and processes loans on their way to approval. The Bank's Realignment document (GA-232), identified the problem in these terms:

> *Efficiency and quality problems are resulting in lengthy preparation periods (the average preparation period for an investment project is 576 days); long execution periods (39% of the portfolio has execution periods of more than 5 years); and difficulties in evaluating the quality of Bank interventions (45% of projects were evaluated ex ante, 18% were evaluated ex post).*

3.35 In response to this diagnosis, Management produced, in October of 2007, a revised set of procedures for loan processing. Called the "New Project Cycle," this approach dramatically streamlined the approvals process for loans, establishing strict timelines to ensure that all required reviews were completed in an expedited manner, and shifting the emphasis inside the Bank from approval to execution. This action effectively eliminated many of the procedural obstacles to approval that had in the past given rise to specialized "instruments" (discussed below) with unique approvals processes designed to avoid these procedural obstacles. The effect of the changes not only on approval times but also on project structure and costs, implementation timetables, and the generation of expected benefits and results, should become apparent in the future.

B. Instrument Reform: Flexible Lending Instruments

3.36 Alongside these general measures to make investment loans more flexible, Management also developed an implemented a variety of new "flexible lending instruments" which were designed to address presumed rigidities in standard investment loans. The first wave of innovation in this area came in 2000, when the Board approved the following "flexible" lending instruments (FLIs): Innovation (INO) and Multi-Phase Program loans (MPL), the Sector Facilities Framework and three initial facilities in education, health and trade (SEF) and the Project Preparation and Execution Facility (PROPEF). On July 16, 2003, the Board of Executive Directors approved two new lending instruments: the Conditional Credit Line for Investment Projects, or CCLIP, and the Performance-Driven Loan, or PDL.

3.37 In the documents proposing these new instruments it is possible to discern two rather different objectives. First, the new instruments were seen as offering

[35] These are documented in GN-2072, "Operations Procedures: Initiatives Proposed by Management", 24 June, 1999.

shorter periods for approval and execution, because "*there is a need to reduce start-up and eligibility delays so that projects can better achieve their developmental impact.*[36] Second, the new instruments allowed adaptive interventions by the Bank, where the precise nature of the intervention evolved over time. Adaptive interventions would focus on results, leading to "*the cementing of partnerships with borrowers, and the encouragement of a results culture.*" Thus the new instruments respond to two of the NLF objectives: making investment loans more flexible, and adopting a programmatic approach. Thus the evaluation will first assess whether the new instruments offered more rapid approval and disbursement than standard investment loans, and then will turn to an assessment of the new instruments in terms of fostering and adaptive, programmatic, approach to the countries.

3.38 Table 3.5 below shows the usage of Bank instruments during the NLF period by number of operations and by total approved amounts. The "new lending instruments" are indicated by shaded rows.

Table 3.5
Instrument Use during NLF period

Code	Name	Number	Amount
ESP	Specific Investment Operation	115	6,570.84
PSL	Private Sector Loan	77	4,808.36
PFM	Multi-Phase Lending Project	34	3,846.09
CLP	Project Using a CCLIP	13	3,000.00
PBP	Programatic Policy Base Loan	20	2,350.00
GOM	Global of Multiple Works Operation	13	2,341.39
PBL	Policy Based Loan	12	1,774.00
PDL	Performance Driven Loan	9	515.00
SUP	Supplementary Financing	5	189.00
SEF	Sector Facility	27	114.00
GCR	Global Credit Operation	2	89.10
HIB	Hybrid Operation	2	51.60
INO	Innovation Operation	5	50.00
ERF	Immediate Response Facility for Emergencies	3	46.70
PEF	Project Preparation & Execution Facility	32	35.80
SMP	SEP & Small Project	46	29.70
OMJ	Opportunities for the Majority	1	25.00
TCR	Technical Cooperation Loan	5	21.40
	TOTAL	421	25,859.00

3.39 The table shows that two of the new instruments, CCLIPs and Multiphase loans have been used extensively, accounting for 47 operations and nearly $7 billion in approvals. Sector facilities and project preparation and execution facilities have produced a significant number of projects, but with relatively small lending volume. Performance driven loans and innovation loans have received very little use.

[36] GN-2085-2 "Proposal for new flexible lending instruments" 17 March, 2000, paragraph 2.04.

3.40 The design of these new instruments focused on speed of approvals. When Management reviewed the use of these instruments in 2002, it stated:

> *An important element of the Flexible Lending Instruments (with the exception of the MPL's first phase*[37]*) is the agility in the preparation and review of operations. The Innovation Loans, the Sector Facilities, and the PROPEF all have simplified and fast-track review processes to ensure timely processing of their approvals.*

3.41 And the CCLIP proposal was similarly explicit on the objectives for this instrument:

> *The Conditional Credit Line for Investment Projects (CCLIP) is a lending instrument for financing investment projects that will increase the Bank's efficiency and <u>speed in the loan preparation and approval process</u>, and reduce loan-processing costs for both the Bank and its Borrowers.*[38]*(Emphasis added).*

3.42 To accomplish these objectives, the flexible lending instruments were given different procedural treatment than standard investment loans. The new processes can be seen in the following table, which outlines the major substantive changes proposed by the new "flexible" instruments. While each instrument had its own objective, none of them entailed any exceptions or changes to Bank policy, only to internal processing procedures. It thus appears that the perceived problems of inflexibility related exclusively to constraints imposed internally by Management, rather than in the policies approved by the Board governing investment lending instruments.

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[37] The exception noted for MPLs applied only to the first phase of the loan. Subsequent phases were expected to be approved quickly. GN-2085-7 "*Operational assessment of the flexible lending instruments,*" paragraph 2.17

[38] GN-2246-1, "Proposal for a new lending instrument. Conditional Credit Line for Investment Projects (CCLIP)," paragraph 1.2

Table 3.6

INSTRUMENT	OBJECTIVE OF NEW INSTRUMENT	CHANGES TO ADMINISTRATIVE PROCEDURES AND BOARD REGULATIONS[1]	EXCEPTIONS/CHANGES TO POLICY[1]
FLEXIBLE LENDING INSTRUMENTS APPROVED IN 2000 (GN-2085-2)			
Innovation Loan (INO)	Support experimentation, pilots, capacity-building and learning, usually prior to preparation of larger program.	• Loan Committee approval by simplified procedure[2] • Board approval by short procedure[3]	None
Multi-Phase Program Loan (PFM)	Provide longer-term support of a far-reaching program which requires more than one project cycle.	• Board approval of second and subsequent phases by simplified procedure based on assessment report of first phase	None
Sector Facilities (SEF)	Provide fast-track support to address sectoral problems through pre-defined, low–cost activities characterized by high relevance and urgency, less complex preparation, rapid execution and high impact.	• Board approves establishment of each sectoral facility, not individual loans • Loan Committee approval of individual loans by short procedure • Executive Summary of individual loans sent to Board for information only	None
Project Preparation & Execution Facility (PROPEF)	Close financing gap between preparation and actual start-up of project in cases where loan eligibility is delayed (extension of Project Preparation Facility)	• Board approves establishment and expansion of Country Credit Lines, not individual operations • Individual operations approved by Division Chief (up to US$1.5m), Department Manager (USS$1.5-3m) or Loan Committee by simplified procedure (above US$3m)	None
ADDITIONAL LENDING INSTRUMENTS APPROVED IN 2003 (GN-2246-1 and GN-2278-2)			
Conditional Credit line for Investment Projects (CCLIP)	Increase the Bank's efficiency and speed in loan preparation and approval process, and reduce loan processing costs for both the Bank and its Borrowers	• Board approves credit line under standard procedure • Loan Committee approval of individual loans by short procedure based on a simplified proposal	None
Performance Drive Loan (PDL)	Disburse resources on the basis of achievement of development results or outcomes.	None	Authorizes use of national procurement rules. Recurrent costs can be financed in all sectors if required to achieve outcomes

[1] Relative to procedures and policies in place at the time for standard investment loans.
[2] Simplified procedure in the case of both Loan Committee and the Board consists of placing the document in the agenda for approval, but formal discussion only takes place if requested by a member in advance.
[3] Short procedure consists of submitting an operation to Loan Committee or the Board at any time and considering it approved after 5 days, unless the process is interrupted by a member.

3.43 As Table 3.7 shows, over the 2000-07 period 248 loans were approved using the FLIs, for a total amount of US$11 billion, and the results generally confirm the expected reduction in approval times. The processing time from pipeline to approval was substantially shorter in the case of both Innovation Loans and Sector Facilities than for investment loans in general; in fact, the preparation period was cut in half on the average (though note the very large standard deviations).[39]

[39] This finding cannot be explained by the small size of the loans (up to US$10 million for INO and up to US$5 million for SEF).

Table 3.7

INVESTMENT LENDING INSTRUMENTS BY TYPE (2000-7)							
	INO	**SEF**	**PROPEF**[1]	**PFM**[2]	**CCLIP**	**PDL**	**OTHER INVESTMENT LOANS**
Number of loans	29	48	84	68	10	9	358
Volume US$ million	226.2	201.7	45.4	7,093.5	3,058.6	445.1	20,190.5
Average approval amount US$ million	7.8	4.3	0.6	104.3	305.9	49.5	59.7
Pipeline to Approval (average in months)	8.6	8.8	--	16.1	10.3	12.8	19.8
standard deviation	7.0	6.0	--	14.8	3.2	4.7	18.1
Approval to Eligibility (months)	11.3	11.9	6.1	12.4	9.0	7.4	12.6
standard deviation	5.7	6.7	4.6	5.2	1.8	6.3	8.0

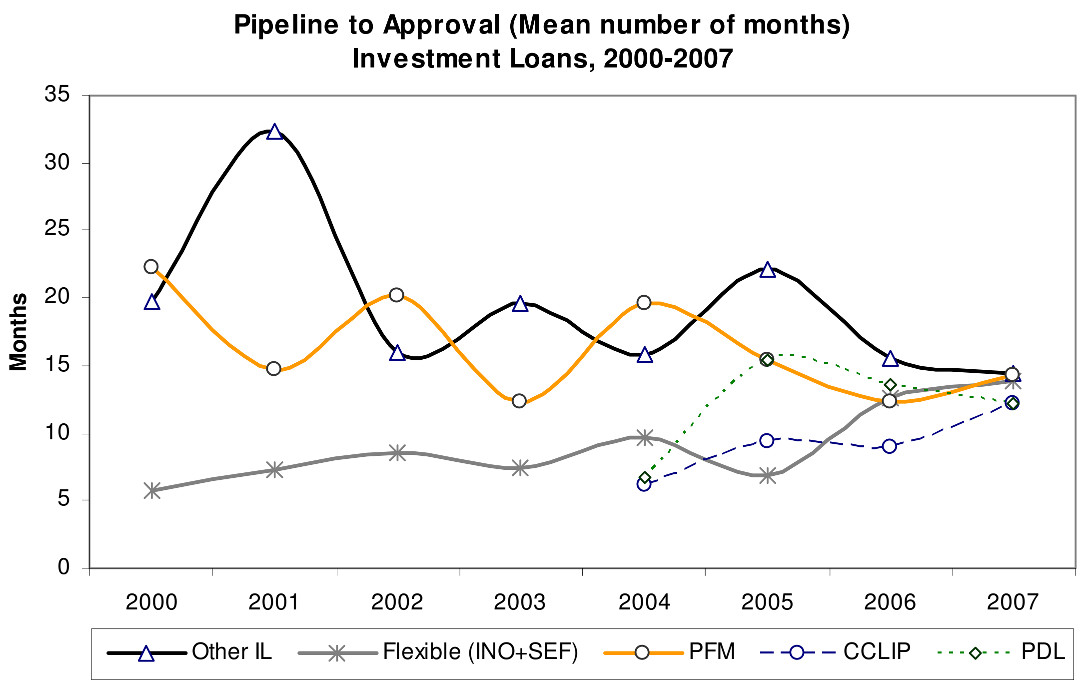
[1] Individual PROPEF operations do not enter the pipeline
[2] For Multi-phase loans, approval times apply only to first phase

3.44 The same was not the case for Multi-Phase loans, nor was it expected, since the changes in processing procedures only applied to second phase.[40] In the case of PROPEF, the only available indicator is the number of months elapsed from approval to eligibility, which is significantly less than for investment loans in general. This is by design, since the instrument is used for project preparation and to fill the gap prior to eligibility, and thus has few if any conditions prior to first disbursement. In the case of the other FLIs, there was only a slight gain in the months elapsed between approval and eligibility compared to the average investment loan.

3.45 While an analysis of specific flexible lending instruments suggests they achieved their objectives of lowering approval times, other data suggest that this may have had less to do with the specific characteristics of the flexible instruments themselves than with the general changes to the Bank's approval processes noted earlier. This is shown clearly in Figure 3.3, which tracks the number of months between the time a project is placed in the Bank's pipeline and its approval date. The chart makes clear that all investment lending, not just the new "flexible lending instruments" are converging to the same elapsed time from pipeline to approval. At least in terms of processing time, there appears to be no advantage to the "flexible" instruments.

[40] By 2007 only 10 multi-phase projects had advanced to the second stage.

Figure 3.3



3.46 The story with respect to disbursement is similar. The new lending instruments have a tendency to disburse somewhat faster than other investment loans, but the gap is narrowing over time. The figures below compare the disbursement patterns on the three most-used investment lending instruments: CCLIPs, Multi Phase, and standard investment loans. Each chart has a line for the year of approval of all loans using a given instrument. The left axis shows the percentage of the originally approved amount that is actually disbursed by the end of each year. The longest line is for projects approved in 2003, with one year less of observed disbursement performance for loans approved in each succeeding year.

3.47 The graphs show several interesting points. First, for all instruments, the year of approval has a powerful effect on the pace of disbursements, suggesting that macro factors in the Region have an influence on how quickly countries accept disbursements. Second, multi-phase operations generally achieve a more rapid pace of disbursement than investment loans, but this relationship disappears for 2006 and 2007. Third, the CCLIP instrument appears to have produced very rapid disbursements, but this data is distorted by a single country. In Brazil the CCLIP instrument has been used to fund the Bank's long-term relationship with BNDS, where funds disburse very rapidly. Outside of Brazil, CCLIP disbursements have been much slower than the other instruments.

3.48 Management's 2007 Assessment of the FLIs, also confirms continuing problems with execution. The most dramatic case was that of Innovation Loans, which were designed to be implemented in 30 months, while the average execution period tuned out to be 56 months.[41]

3.49 Box 3.1 extracts the "Key Findings" section from the executive summary of that review. The emphasized phrases indicate that execution problems appeared to have negatively affected <u>all</u> of the new flexible instruments.

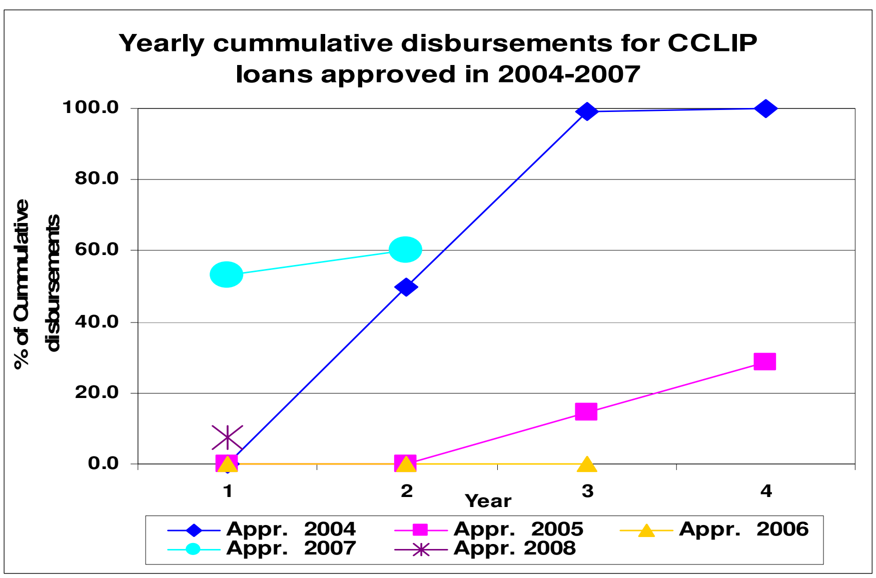
Box 3.1

Key Findings

This assessment brings to light a number of findings. First, demand for Innovation Loans has dropped because their experimental focus requires careful monitoring, <u>flexibility during loan implementation</u>, and significantly more time to execute than 30 months. Second, although the portfolio is young, disbursement rates on the Sector Facilities have been disappointing and there are <u>no pre-identified and fast tracked methods to execute these loans.</u> Third, Multi-phase Loans, especially institutional and innovative operations, are increasing in demand due to their flexible framework. And fourth, Project Preparation and Execution Facility projects are increasingly important tools for the Bank and Borrower to cover financing gaps after project preparation activities are completed to initiate project execution. The report also highlights that the focus of Bank instruments increasingly <u>needs to be more centered on project execution</u> to achieve intended development results.

Source: "Operational assessment of the flexible lending instruments", (GN-2085-15). (emphasis added)

3.50 The following charts address implementation issues by each of the extensively-used lending instruments (ESP, PFM and CCLIP).



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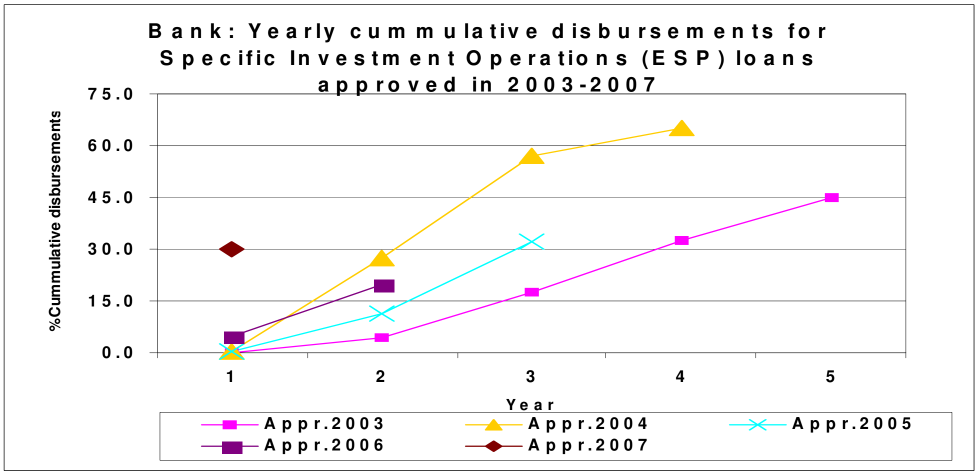
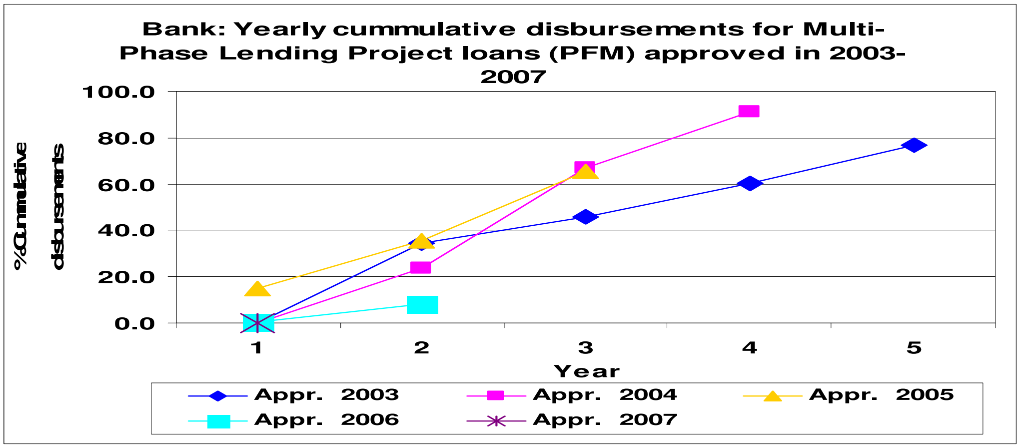
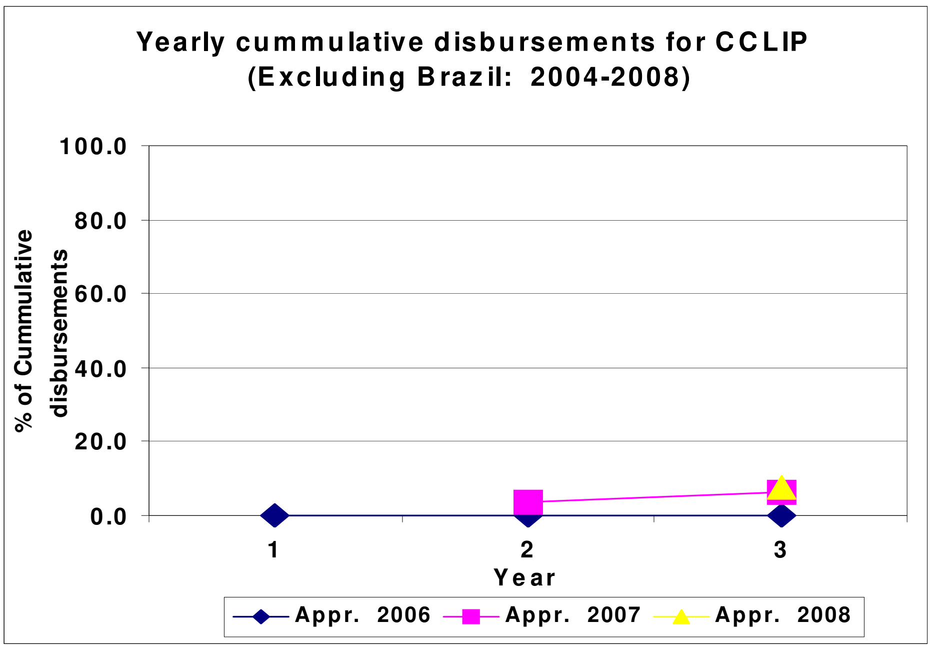
[41] The delays in execution were attributed to "their experimental focus and their design to test new methodologies and partners." (Paragraph 2.9) However, the very next paragraph notes that INO is being used "more as a small loan instrument and a tool for expedited approval, and not as a learning instrument." It is thus not clear whether the "experimental focus" was the source of delay or not.

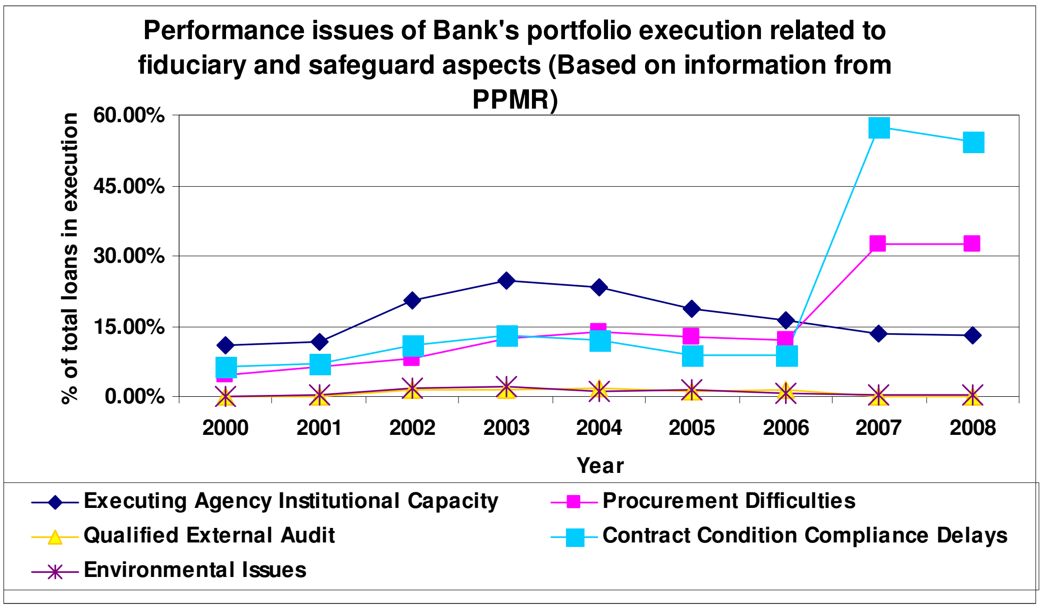

Bank: Yearly cummulative disbursements for Specific Investment Operations (ESP) loans approved in 2003-2007
%Cummulative disbursements
75.0
60.0
45.0
30.0
15.0
0.0
1
2
3
4
5
Year
Appr.2003
Appr.2004
Appr.2005
Appr.2006
Appr.2007


Bank: Yearly cummulative disbursements for Multi-Phase Lending Project loans (PFM) approved in 2003-2007
%Cummulative disbursements
100.0
80.0
60.0
40.0
20.0
0.0
1
2
3
4
5
Year
Appr. 2003
Appr. 2004
Appr. 2005
Appr. 2006
Appr. 2007


Yearly cummulative disbursements for CCLIP (Excluding Brazil: 2004-2008)
% of Cummulative disbursements
100.0
80.0
60.0
40.0
20.0
0.0
1
2
3
Year
Appr. 2006
Appr. 2007
Appr. 2008

3.51 But the charts also suggest that the Bank may have different execution issues as between older loans and newer ones. The preceding charts document show what is happening with respect to the "flow" of new loan approvals. Looking at the "stock" of already approved loans suggest a much larger problem with disbursement execution than is shown for the flow of new approvals. For this evaluation, OVE reviewed the database of Project Performance and Monitoring Reports (PPMRs) prepared every six months by staff in the Bank's country offices. The review sought to determine the nature of the explanations offered in the PPMRs for execution problems. The results are shown in Figure 3.4.

Figure 3.4



3.52 The chart shows that, until 2006, the principal factor cited to explain execution problems was the "capacity" of the executing agencies. In 2007 and 2008, however, this explanation remains at previous levels, while there is a several-fold increase in explanations relating to contracting and procurement issues. These results hold across all Bank instruments, and there is no particular advantage for the "new lending instruments."

3.53 From an analysis of the text of the PPMRs it appears that international competitive bidding is perceived as a problem, but that the real issue is the review of actual expenditures. Since Bank contracts require either ex-ante or ex-post review of expenditures to determine if they were in compliance with Bank rules and the specific clauses of the loan contract, it is these reviews that constitute the principal obstacle to disbursement.

3.54 These findings suggest an alternative possible explanation for the past perceived bias in favor of PBLs. Such loans may have been preferred in the past because they <u>had no procurement</u>. Because they were not designed to track specific expenditures, PBLs have simplified contractual clauses (primarily relating to policy change), and are disbursed directly to governments without involving procurement from private vendors, and thus also not requiring the ex-post validation of expenditures.

3.55 Partial confirmation for this hypothesis can be found by examining recent changes to investment lending operations. A review of these loans finds two interesting changes: First, many of them are very large. The largest ten operations approved from 2000 to 2007 represented on average 74% of annual approvals and 75% of cumulative approvals of investment loans. Second, many of these very large investment operations have objectives that do not require procurement.

3.56 Such loans operate by direct transfer of resources to a large number of beneficiaries, be they small businesses (BNDS) or poor families (conditional cash transfers). Bank disbursements go to the intermediaries in large tranches, without procurement, and are then "retailed" by the intermediaries to final beneficiaries. Over the last few years, 45% of the "wholesale" investment loan approvals were for conditional cash transfers, another 30.3% corresponds to PYME support (including BNDES), while 7% went for regional development programs and 5.9% in housing programs.

3.57 In light of these findings, it is OVE's conclusion that the decline in the bias in favor of PBLs noted in Figure 3.1 is not the result of the creation and use of "new lending instruments." Instead, it relates to generalized changes in how Bank operations are processed and to the relaxation of restrictions on counterpart financing and on the expenditures eligible to be financed. Both "traditional" and "flexible" lending instruments exhibit a pattern of increased disbursement on newly approved operations. Finally, many new investment operations have found ways to minimize the problems with procurement and contract compliance which have been the source of execution delays in the past. These changes are innovations within the existing constraints, and do not represent an explicit change in policy.

3.58 Finally, in reviewing the Bank's history of experimentation with "new" and "flexible" lending instruments, it is important to recall that flexibility was not linked exclusively to the pace of approval or disbursement. Instead, flexibility was seen as an essential requirement to allow the Bank to focus more on results and less on rules. As a 2003 document on "flexibility in lending" made clear:

> *To stimulate innovation in responding to our clientele, the Bank should shift its focus from controlling processes and procedures, to measuring the results of its activities. Such a shift towards a culture of results may require the development of different types of instruments or innovation in their application.*[42]

3.59 Despite this stated intent, projects supported with the new flexible lending instruments do not achieve significantly higher evaluability scores than ordinary investment lending operations, indicating no significant improvement in results tracking for these instruments.

3.60 In light of these conclusions, OVE would reiterate the recommendation of RE-300 to radically simplify the Bank's instrument mix. RE-300 recommended that:

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42 CC-5876, "Flexibility in Lending" July, 2003. Paragraph 1.14.

Focus on countries rather than instruments. Instruments are tools for producing economic gains for the countries, and it is the generation of gains, not compliance with rules and procedures built into instruments that should be the focus of Bank activity. This requires further efforts to strengthen the country programming process taking as a point of departure the guidelines set by the Board of Executive Directors in 2002. Country strategies should focus on a strategically-selected, limited range of problems and propose an integrated package of shorter and longer term solutions that provides the highest possible return to the country, without regard to pre-defined notions of appropriate instrument mix.

> **Recommendation 7**: ***Adopt a programmatic approach***
>
> *The Bank could adopt a programmatic approach to its activities in the countries and sectors that have demonstrated the capacity to do so. This approach consists of utilizing all IDB instruments available to help countries implement programs and achieve commonly set objectives in sectors or areas of activities where there are conditions to effectively implement such an approach.*

3.61 It is important to recognize that this instruction does not clearly define what is meant by a "programmatic approach." In RE-300, OVE examined trends at the World Bank and argued that they were being "programmatic" by moving from a focus on instruments to a focus on problems.

Such changes are moving the World Bank toward a situation where ***there are no instruments;*** *there are only countries with development needs. Those needs are addressed with programs of financial assistance integrated with country budgetary processes that provide a clear positive economic rate of return by supporting a combination of policy reform, asset creation and efficiency improvements in existing resource flows. What matters is the return provided by the package, not the individual elements in it. (Paragraph 8.13)*

3.62 Although the NLF devoted a section to discussing OVE's "programmatic approach," it focused on the distinction between investment loans and PBLs rather than the integrated approach described above. As a result, the NLF recommendation to "adopt a programmatic approach" retains the old focus on individual instruments. In fact, by suggesting that a programmatic approach required "utilizing all instruments," the NLF actually established an impossible standard, given the number of instruments in use at the Bank.

3.63 In OVE's view, a programmatic approach requires three things: First, a long-term commitment to address a particular problem in a country. A programmatic approach is not a one-shot, one-project approach. Second, a clear joint statement by the Bank and the country regarding the results to be achieved over time as a result of this engagement. A programmatic approach is results-focused. Third, the effective integration of Bank resources with country systems and resources in the pursuit of the common results agenda. A programmatic approach is a partnership, with the country in the lead.

3.64 Aside from the emphasis on individual instruments, the NLF language contains emphasis similar to OVE's with respect to results focus, since the approach requires the specification of "commonly set objectives" whose achievement is monitored as part of the process. The NLF language is, however, much more restrictive with respect to country leadership in implementation, arguing that the approach can be used only in countries or sectors that have "demonstrated the capacity" to do so. This last point creates a need at the Bank for some standards and assessment tools to decide which countries and sectors are eligible for such an approach.

3.65 In keeping with its traditional instrument focus, the Bank has devised a number of instruments and "modalities" that incorporate, albeit with different levels of specificity, this kind of programmatic approach. These include the "investment" lending instruments of Multi Phase and Performance-Based loans, as well as "programmatic" variety of policy-based lending. They also include two "modalities" of lending, CClips and SWAps, which incorporate other instruments under them. Table 3.8 provides a summary of the characteristics of these programmatic instruments in terms of the criteria outlined above.

Table 3.8. Programmatic Instruments

Instrument	Description	Performance Elements	Country Leadership
SWAp	*All development partners… collaborate to support a single government-led sector policy and expenditure program, adopting common approaches across the sector, and progressing towards relying on government procedures to disburse and account for all funds*	Participants agree on: (i) a set of program output and outcome indicators with time-bound targets; (ii)the baseline data on the selected indicators, that will need to be available prior to approval, to track their progress; and (iii) the performance monitoring system to be used.	Pooled funding Country administration of funds
Multi-Phase	Provide systemic and longer-term support of a far-reaching investment program, which by the nature of its complexity would take more than one project cycle to complete.	(i) clear identification of long-term development goals of the program; sequencing of loans for phased support of the program with the first phase containing specific objectives, milestones, performance indicators and policy requirements	None
CCLIP	Provides a credit line to finance similar investment projects in those cases where there is a good track record of similar previous Bank-financed operations	*is a performance-based instrument, since it can only be used in those cases where successful project performance can be demonstrated both with respect to execution and results.*	None
PDL	*The PDL is an investment loan that disburses once the project or program's actual development results or outcomes are achieved, and the Bank has verified the expenditures incurred by the Borrower to reach the outcomes.*		Exempt from procurement rules Recurrent costs could also be financed as long as they form part of the expenditures required to achieve the project's outcomes.

Instrument	Description	Performance Elements	Country Leadership
PBP	A series of single tranche operations (each with their own Loan Contract), set within a medium-term framework of reforms/institutional changes, approved on a phased basis	(a) clear monitorable indicators and progress milestones, (b) triggers for moving from one operation in the series to the next, and (c) notional timing and amounts of subsequent operations.	None

3.66 In implementation, the different programmatic instruments have had very different trajectories. CClips and Multi-Phase loans have been used extensively, despite some major problems in execution. The "programmatic" version of policy based lending has become the preferred instrument of this type. PDLs and SWAps, on the other hand, have been seen as problematic and not used extensively. The history of these different instruments, discussed below, contains a number of lessons for the Bank on the future task of becoming more programmatic.

3.67 Table 3.9 below shows the number of programmatic instruments deployed by country during the NLF period. Three facts stand out. First, compared with standard investment operations, only a relatively small number of countries have made use of programmatic instruments. Second, multi-phase loans are the programmatic instrument with the broadest use, having been used in 16 of the Bank's borrowing member countries. Third, where a country makes use of one programmatic instrument, it is quite likely that it will also use other programmatic instruments. Four countries, Brazil, Argentina, Chile and Colombia account for the vast majority of all programmatic operations.

Table 3.9
Programmatic Instruments:
Number of Operations by Country

ESP		PFM		PBP		PDL		CLP		SWAps	
11	AR	3	AR	1	BO	1	AR	6	AR	1	BR
5	BO	1	BA	4	CO	1	BO	2	BR	1	ES
11	BR	1	BH	1	EC	2	CH	2	CH	1	EC
3	CH	2	BR	1	ES	1	CO	1	CO	1	PN
8	CO	1	CH	2	GU	1	HO	1	CR	1	CO
3	CR	2	CO	2	HA	1	PE	1	PE		
4	DR	1	CR	1	JA	2	PR				
5	EC	2	DR	5	PE						
3	ES	3	EC	1	PR						
5	GU	1	ES	2	UR						
4	GY	2	GU								
9	HA	1	HO								
4	HO	5	ME								
2	ME	2	NI								
7	NI	6	PN								
4	PE	1	PR								
8	PN										
5	PR										
1	RG										
2	TT										
6	UR										
6	VE										

3.68 **Multi Phase Loans.** Although formally part of the Bank's new "flexible lending instruments, Multi-phase loans are in fact not new. In a number of sectors, the Bank has for years approved investment loans titled "Phase I" in large and important sectors such as housing and transportation. These were always categorized simply as investment lending operations before the creation of the "PFM" loan type in 2000. In fact, six of the loans currently categorized as PFM operations in the Bank's data base were approved in the 1980s and 1990s, and were obviously re-labeled as multi-phase operations after the approval of the new instrument.

3.69 In programmatic terms, these loans embody the concept of long-term engagement, and are explicitly results-focused by the requirement that earlier loans establish clear "triggers" for performance, triggers that need to be met before moving to a second phase. They remain, however, Bank-focused lending operations, and are not designed to place increasing reliance on country systems for execution.

3.70 The full programmatic promise of such loans does not materialize, however, until the Bank and the country confront the task of developing a second phase. It is then that performance needs to be assessed in light of the "triggers" established in the first phase. To date, eight operations have had this kind of review leading to the approval of a second phase.

3.71 As Tables 3.2 and 3.8 suggest, Multi-phase loans have been used extensively, and in a majority of the Bank's borrowing member countries. They have been used across a number of sectors, but lending volume has been concentrated in social protection and infrastructure. A review of the design of these instruments, including their "triggers," suggests that they are focused on long-term development in their chosen sector, and attempt to both measure progress over time and adapt the intervention to changing conditions in the country and sector.

3.72 **CCLIP.** The CCLIP is a lending "modality" rather than an instrument itself. It provides countries with an overall credit line which constitutes a "conditional commitment" from the Bank to fund future individual operations under from this line. As a conditional commitment, the Bank only commits lending authority when specific operations are approved, and thus the countries are not required to pay commitment fees on the entire credit line.

3.73 This modality was approved by the Board in 2003, and was originally conceived to be "*a performance-based instrument, since it can only be used in those cases where successful project performance can be demonstrated both with respect to execution and results*." To obtain a credit line the Borrower needed to have completely executed at least one similar Bank project with satisfactory execution and satisfactory progress in achieving expected results. In addition, the executing agency needed to demonstrate both satisfactory past performance and an expectation of continued good performance in the future.

3.74 As a modality rather than an instrument, CCLIP operations are not tracked consistently in the Bank's project data base. According to that database, CCLIPs have been used for 13 operations during the NLF period, however, an individual loan to Chile under a CCLIP is recorded as a performance-driven loan, while another loan to Paraguay is recorded as a global credit operation. Using the Bank's official data, however, CCLIPs have approved $3 billion during the period as against the $3.8 billion approved in PFM operations. $2 billion of this, however, is accounted for by two loans to BNDS, thus distorting somewhat the picture of how this instrument has been used.

3.75 The programmatic features of the original CCLIP proposal were based on its long-term commitment to a particular executing agency, whose performance was to be assessed prior to approval and reassessed with each new operation approved under the umbrella of the CCLIP. By design, CCLIPs are less programmatic than multi-phase operations, since no specification of long-term sector performance goals is required, and there are no formal performance "triggers" to measure progress as the program unfolds. In execution, however, even the few modest programmatic features of the CCLIP have been progressively eroded.

3.76 In December of 2006, Management sent to the Board recommendations for modifying a number of aspects of the CCLIP. The document noted that "*the Bank continues to be challenged by requests for new types of CCLIP lending*." The "challenge" was that many executing agencies wanted to use this instrument, whether or not they had a record of successful project execution with the Bank. This demand came from both central government agencies, and sub-national entities.

3.77 In response to this "challenge," Management proposed to expand eligibility for CCLIPs to any entity provided that "*the borrower/executing agency can demonstrate a solid institutional and financial track record and have successfully executed projects of a similar scope and nature*." Precisely how this criteria was to be met was left unclear, but a footnote promised that "*An evaluation is to be carried out with respect to the reports which best reveal the condition of the executing agency and the project…*" OVE has been unable to determine whether this evaluation was carried out, and has similarly been unable to find any evidence that any applicant has been excluded from using the CCLIP instrument because of inadequate performance. Thus the performance feature of the instrument appears to have been eliminated.

3.78 Two other important changes to the instrument were also made at the same time: CCLIPs were allowed to be "multi-sectoral," and sub-national government entities were declared eligible for participation. While the original CCLIP was to provide continuity of focus to a single sector through different individual operations, the "multi-sectoral" CCLIP could finance completely unrelated projects in completely unrelated sectors. Including sub-national government entities with no experience in borrowing from multilateral agencies created risks, which the document proposed to manage in the following fashion:

> *In this type of CCLIP where the individual operations would consist of loans to sub-nationals, the operations would only be eligible for funding when the financial conditions established by the government are fulfilled and follow national legislation regarding fiscal transparency. Therefore, these operations would be presented for Bank financing once the national government provided, for each sub-national government requesting a loan, the verification of indebtedness, borrowing capacity and financial soundness, among other considerations.*

3.79 All of these proposed changes were adopted by the Board, with the end result that the "redesigned" CCLIPs had virtually no "programmatic" features left. They had become an efficient financial instrument (no commitment fee for the credit line), that could be used by any government/agency to finance any combination of individual projects in any combination of sectors. There were no agreed-upon results to be achieved, and the performance assessment of institutions had become no serious obstacle to participation.

3.80 In light of this analysis, the surprising thing about CCLIPs was how infrequently they have been used, and how slowly they have disbursed. Only three countries, Argentina, Brazil and Chile have accounted for the vast bulk of CCLIPs, but there have been significant disbursements only in Brazil, principally because the Bank's longstanding relationship with BNDS has been implemented in recent years as a CCLIP. Peru, Costa Rica and Colombia have each taken one CCLIP, but there have not yet been any disbursements. It is thus not possible at this point to offer any meaningful evaluation of this instrument.

3.81 It does appear, however, that demand for CCLIPs is accelerating. This instrument has accounted for 10% of the volume of approvals from 2004-2007, but rose to 26% of approvals thus far in 2008, and account for 23% of the current future pipeline. In contrast, regular investment lending was 27% of approvals volume between 2004-2007, but accounts f or 24% of the current pipeline. If these trends continue, CCLIPs will exceed regular investment lending as a share of Bank activity in the near future.

3.82 **Sector-Wide Approaches (SWAps).** This "modality" is the approach with the most explicit programmatic features. Approved in 2004 after lengthy discussion, the approach was defined in the following terms:

> *A SWAp is an approach by which all development partners, involved in a sector, collaborate to support a single government-led sector policy and expenditure program, adopting common approaches across the sector, and progressing towards relying on government procedures to disburse and account for all funds. A SWAp is not a lending instrument but rather an approach that can be supported by any of the Bank's investment lending instruments.*[43]

3.83 The SWAp was not a novel idea. It had been used extensively by the World Bank and bilateral donors in aid-dependent countries, especially in Africa and Asia, as a means to support a sector strategy or program in a coordinated and harmonized manner. In these cases, while all donors agreed to support the same program and thus focus on agreed upon priorities, resources were only sometimes pooled among the donors or with the recipient country.

3.84 The IDB itself already had a long experience in co-financing projects, especially with the World Bank, undertaking joint preparation and administration efforts, even if resources were not pooled and processes and procedures were only slowly being harmonized. Another SWAp concept, that each partner agreed to finance a part of a government medium term investment plan, had also been available since 1970 through time-slice operations. In fact, a 2004 document from Management noted that the new instrument was initially named a time-slice, but was changed to SWAp to maintain consistency with other MDBs.[44]

3.85 From a design point of view, several features were essential to make the SWAp a truly programmatic tool. First, the Government had to articulate a clear framework for the sector, subsector or program, with an associated expenditure framework linked to its budget process. Second, the Government had to involve its selected partners in a collaborative process, whereby resources would be either

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43 GN-2330-6, October, 2004, Executive Summary. Paragraph 1.

44 GN-2272-1 "An approach for further development of lending instruments and operational Policies", 14 May 2004

pooled into a common account or placed in separate sub-accounts but managed through a common process. Third, and most important, SWAps would use local systems for financial administration, procurement and auditing, effectively eliminating the ring-fencing associated with project financing.

3.86 However, the approval and implementation of the SWAp approach proved problematic, and the instrument has failed to achieve the expectations set for it. Board discussion of the matter revealed strong reservations from a number of shareholders, particularly regarding the adequacy of country procurement and financial management systems. To address these concerns, Management proposed the following future action:

> *If the Proposal for Sector-Wide Approaches (GN-2330) is approved, Management would proceed to elaborate operational guidelines for the use of SWAps. Among other things, these guidelines would include all the elements necessary to help project teams ensure that any common procedures (be they Borrower procedures or those of other participating financiers) used by the Bank in a SWAp be either equivalent to or exceed the Bank's standards.*[45]

3.87 Despite this promise, such guidelines were never prepared. Thus one of the key prerequisites for a "programmatic approach" – reliance on country systems– was compromised from the start by failing to specify precisely how countries could be assessed with respect to capacity to implement.

3.88 Pooled funding was another concept that proved difficult to implement. SWAP projects were required to use Bank procurement rules above the International Competitive Bidding threshold, and such procurement could not be managed with pooled resources. This effectively eliminated infrastructure projects from the SWAps.

3.89 Table 3.10 shows that to date, only five loans have been approved, and one of them has been cancelled. All of them were in the social sectors, primarily financing demand-side subsidies. This is unsurprising: these loans involving literally millions of individual transactions and the use of a pooled account does not require the routine verification of individual transactions by the Bank, relying instead on internal and external controls.

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[45] Management's response to questions raised by the US. Chair on the proposal for sector-wide approaches. GN-2330-2, 29 September 2004.

Table 3.10

SWAP OPERATIONS 2004-7					
Operation	**Year**	**Title**	**Amount**	**Pooled arrangement**	**Fiduciary arrangements**
BR-L1004	2004	Social Protection System	US$1,000	98.3% of IDB resources pooled with Government, representing 13% of the cash transfer programs financed. 97% of WB resources pooled with Government, representing 9% of the cash transfer programs financed. Remainder of IDB and WB resources directed at technical assistance and not pooled.	In the case of both Banks, pooled funding managed and audited using national systems. Individual transactions are not tracked. Overall expenditures are tracked through Brazil's Integrated System of Financial Management, and the Banks reimburse the agreed upon percentage. Overall expenditures are audited by the Brazilian Federal Secretariat of Internal Control and do not discriminate the source of funds.
ES-L1002 CANCELLED	2005	Solidarity Network	US$57	9% of IDB resources and 71% of WB resources are pooled to contract health and nutrition services. There are no government resources in this component.	Two components, which have both IDB and WB resources, will use WB procurement procedures for amounts below the IDB threshold for ICB. The largest IDB component (84% of loan resources) is devoted to basic infrastructure and equipment and will be financed according to IDB rules. There will be a single program audit, selected according to IDB procedures.
EC-L1025	2006	Universal Health Insurance System	US$90	No pooled account. Co-financing arrangement with World Bank. No counterpart resources.	Use of Bank procedures for procurement for financial management. Monitoring system developed by World Bank.
PN-L1007	2007	Social Protection	US$20	Pooled account with World Bank.	Financial management and auditing will follow IDB rules. Exception requested to carry out IDB from pooled funding, using WB rules. Under other subcomponents, IDB rules will be followed.
CO-L1021	2007	Familias en Acción	US$305	93% of IDB resources pooled with Government and World Bank, representing 64% of cash transfers in first phase of program. This does not include new loan to be approved by the WB.	In the case of both Banks, pooled funding will be managed in accordance to Colombian financial administration systems "once they have been positively evaluated by the Bank." Auditing will be carried out by an external firm, as the Office of the Comptroller General is not in a technical, operational or financial position to audit the program; this is expected in the second phase.

3.90 Perhaps more interesting, all the loans involved the World Bank. In one of these there was no pooling at all, while in the other two, pooling is done solely with the

World Bank, adopting a mix of IDB and World Bank policies. It is likely that these two loans would have been approved by requesting exception to use World Bank policies. Thus there were only two cases in which the IDB pooled its resources not only with the World Bank but also with the Government, adopting national systems (though with some limitations).

3.91 The SWAp approach, designed as the most extensive and ambitious "programmatic" approach, has thus far been unable to realize its promise. Rather than transcending internal Bank obstacles in pursuit of country development objectives, the SWAp approach has been limited by the same familiar problems related to procurement and fiduciary controls. While extensive training for staff on the use of the instrument was carried out, a key obstacle was the lack of interaction among Bank units. Specifically, the analysis required to assess country systems depended on specialized knowledge of fiduciary and procurement systems, not available in the functional divisions, while experts on these topics at the Bank were primarily focused on enforcing Bank procedures.

3.92 The root cause of this problem is that the Bank does not have a standardized mechanism for determining the adequacy of country systems and no process for identifying countries as capable of managing SWAp resources. The World Bank has a process in this area, but the IDB does not. To date, Management has not responded effectively to the following NLF instruction relating to the essential prerequisites for an effective implementation of a programmatic approach:

> *Priority must be given to helping countries develop adequate systems for fiduciary accountability, according to standards set in agreement with the international community, and ensuring that they meet or exceed Bank standards. (Text of NLF Recommendation 7)*

3.93 **Performance-driven loans**. In December of 2003, the Board approved a proposal for a six-year pilot program for Performance-Driven Loans (PDLs) (GN-2278-2). These loans were designed to tie disbursements to the achievement of actual results. This was expected to produce profound change in the way the Bank works with the countries:

> *With disbursements linked to the achievement of outcome targets, the Bank will need to focus its efforts on project outcomes rather than project inputs and processes. The focus will be primarily on the identification of project outcomes, the selection of outcome indicators, setting outcome targets, ensuring that a solid and reliable system is in place to track outcome indicators, and verifying the achievement of targets for disbursement.*

3.94 Between 2005 and the present, the Bank has approved 9 projects coded as PDL in the Bank's database, for a total of $5.15 million or just under 2% of the lending approved during the NLF period (See table 3.11). The issue of "coded in the Bank's database" arises because two of the large operations in Chile are also defined as using the CCLIP instrument.

Table 3.11
Performance-Driven Loan Approvals

Project	Name	Value in $ Millions
AR-L1017	Development of Satellite System and Applications Program	50.0
BO-L1007	Consolidation of Institutional Reform in the Revenue Area	15.0
CH-L1025	Rural Sanitation Program SUBDERE (CCLIP)	100.0
CH-L1026	Integrated Solid Waste Management (CLIPP)	100.0
CO-L1002	Support to the Extended Vaccinations Program - PAI	107.0
HO-L1002	Improvement of Health Conditions in Honduras	16.6
PE-L1020	Support to Water for Everyone Program - Sedapal (SPDL)	50.0
PR-L1001	Modernization of Agricultural Support Management	31.5
PR-L1017	Escuela Viva Program II	45.0
	Total	515.1

3.95 The low utilization rate of this instrument was explained by Management in a 2007 review as relating primarily to two factors: the difficulty of matching expected results with programmed resources, and the implementation problems associated with needing to verify expenditures. Both relate to an ambiguity at the heart of the PDL instrument itself. The document that created PDLs defined them in the following terms:

> *The performance-driven loan (PDL) is an investment loan that disburses once the project or program's actual developmental results or outcomes are achieved, and the Bank has verified the expenditures incurred by the Borrower to reach the outcomes.*

3.96 The key word in this definition is "and," since it links outcomes achieved to expenditures incurred. Such a connection is not necessarily required by the concept of payment for results. Theoretically, the Bank and a country could agree on a specified payment for a given result, and make the payment once the result was achieved. By linking the results to "verified expenditures", however, the execution task becomes harder. A PDL needs to demonstrate not only that its outcomes were achieved, but that those outcomes were the direct result of verified expenditures made. This creates the following problem, noted by Management in its review of PDLs:

> *Establishing a direct relationship between expenditures and performance outcomes is challenging, and in many cases unrealistic, particularly in sectors where the Bank and other multiple donors are supporting a national development goal. Such is the case in the health sector, for example, where outputs such as training of health professionals can be costed-out, but the final outcome of reducing mortality rates for children under five years of age is actually achieved through financing a combination of activities and many outputs. Given that the accountability rests with the executing agency to select the most cost-effective input-output mix for achieving the performance targets, the task of costing activities and outputs loses relevance.*

3.97 Not only does activity costing lose relevance to the performance objective, but the rules of the PDL instrument actually shift the focus of the Bank away from development outcomes to focus on verification of expenditures. Again, Management's assessment:

> *The fact that PDLs, as investment loans, are required to track eligible expenditures directly related to the outputs and outcomes established in the results matrix, constitutes a burden for both the borrowing member countries and Bank staff, since they carry the exact same accounting and reporting requirements as a regular investment loan. This goes against the spirit of the PDL, defeating the purpose of this instrument and contributing to a significant delay in disbursements.*

3.98 OVE concurs with Management's analysis of this instrument, where, once again, the problem lies with the management of disbursements rather than the solving of country development problems. OVE has reservations, however, with respect to Management's proposed solution to this problem:

> *The verification of expenditures as a requisite for disbursement of Bank financing is eliminated subject to the following: (i) the Bank has verified the existence of a strong well-functioning financial management, accounting and internal control system at the executing agency level. An up-front fiduciary risk assessment will be performed, and when applicable, an institutional assessment will be carried out directly by the Bank or with the support of an independent firm.*

3.99 As noted earlier, the Bank has no standardized and validated system for "verifying the existence of a strong, well-functioning financial management, accounting and internal control system". Such a system would need to be implemented within the Bank before a recommendation of this kind could be considered.

3.100 **Programmatic Policy-based Lending** The final "programmatic" instrument of the NLF period was a new variety of policy based lending described first in the "Guidelines for Policy Based Lending" which were called for in the NLF. According to these Guidelines, "Programmatic Policy Based Loans" (PBP):

> *…consist of a series of single tranche operations (each with their own Loan Contract), set within a medium-term framework of reforms/institutional changes, approved on a phased basis to support the borrower in achieving the country's reform program, with specified triggers for moving from one operation to the next.*

3.101 The "programmatic" features of this instrument are thus the long-term commitment to a sector or reform program, supported by sequential operations that are triggered by specific provisions in prior loans. Because it is a policy-based instrument rather than an investment instrument, resources in PBP operations are managed almost entirely using local systems.

3.102 PBP operations have been well-received during the NLF period. Table 3.12 documents approvals during the NLF of 20 such loans for a total value of $2.3 billion, or 9% of the overall lending program.

Table 3.12
Programmatic Policy Based Loans

Project	Name	Value in millions
BO-L1005	Improve Efficiency of Public Management	15.0
CO-L1007	Competitiveness in Colombia I	200.0
CO-L1014	Social Reform and Equity I	200.0
CO-L1026	Social Reform and Equity II	300.0
CO-L1027	Competitiveness Enhancement Program II	300.0
EC-L1004	Competitiveness Improvement I	50.0
ES-0140	Social Policy Support Program	100.0
GU-L1005	Public Financial Management	100.0
GU-L1008	Public Financial Management Reform Program II	100.0
HA-L1017	Strengthening Public Resource Management	12.5
HA-L1023	Strengthening Public Finance Management II	12.5
JA-L1001	Competitiveness Enhancement Program	30.0
PE-L1012	Public Expenditure Quality Improvement I	200.0
PE-L1017	Public Expenditure Management Quality II	200.0
PE-L1024	Water Resources Reform Program I	200.0
PE-L1025	Sanitation Sector Reform Program I	100.0
PE-L1027	Public Expenditure Management Quality III	75.0
PR-L1012	Programmatic Public Financial Reform Operation	30.0
UR-L1007	Programmatic Competitiveness Loan I	75.0
UR-L1021	Tax Administration and Public Expenditures	50.0
	TOTAL	**2,350.0**

3.103 Table 3.13 shows the trend in approvals over time, both in number of operations and the sums approved. While the overall level of approvals of policy-based lending has fallen, a sharp shift in preference among PBL varieties is apparent. By 2007, 98.6% of all policy-based lending was approved using the "programmatic" variant.

Table 3.13
Annual Approvals
(Number of projects and total approved amount)

Year	PBL	PBP	Total
2004	7		7
	$1,655		$1,655
2005	3	3	6
	$875	$245	$1,120
2006	8	7	15
	$888	$900	$1,788
2007	1	7	8
	$12	$863	$875
Total	**19**	**17**	**36**
	$3,430	**$2,008**	**$5,437**

3.104 In concept, programmatic policy based loans resemble multi-phase investment lending operations, in that both embrace a long-term view and both use triggers to assess results to date in devising the next operation. Most PBP operations have been succeeded by another single-tranche PBP in the same sector, a result that has not generally been the case with "traditional" PBL operations. Colombia has completed two series of two individual loans each, one in the area of Social Reform and one in the area of Competitiveness. Peru has completed a three-loan series in Public Expenditure Quality, and has started a series for Water Resources Reform and another for Sanitation Sector Reform. Finally, while Ecuador approved one PBP for Competitiveness in 2006 –that had delays in disbursing–, it has in its pipeline the second and third loans of this series, as well as first operations for Social Reform and Water and Sanitation.

3.105 While this pattern of usage suggests continued engagement with a sector, the performance-focused elements of PBP operations have been less clearly defined. According to the guidelines:

> *The triggers are planned actions in the subsequent years of a program that are deemed critical to achieving the program's objective and that will be the basis for establishing the disbursement conditions for the subsequent loan in the series….During implementation of the program, the Bank evaluates the achievements with respect to triggers to finalize the decision on the scope, timing and disbursement conditions for each later operation in the programmatic series.*

3.106 A review of trigger mechanisms in PBP operations shows considerable variation across countries and sectors. In keeping with regular PBL operations, performance expectations are often couched in vague terms related to country effort ("develop a plan," "implement recommendations", "approve a policy"). Outcome measures are rarely defined in the sections dealing with triggers for future programs.

3.107 There are exceptions. In the first competitiveness PBP for Colombia, for example, one of the triggers for the second PBP was evidence that outsourcing of training had increased at the national training institute. In the follow-on PBP, it was noted that this trigger condition had not been fulfilled, but the loan was approved without it. In the document for the second PBP, the term "triggers" is replaced with the term "indicative targets", and these refer only to the triggers of the first loan. There is no mention of a third loan, and thus neither "triggers" nor "indicative targets" for the future.

3.108 In part as a result of this flexible interpretation of performance triggers, PBP operations generally disburse well. There are no procurement issues to slow down disbursements, and compliance with the generalized "indicative" performance objectives has also not been an obstacle.

C. Recommendations

3.109 This review of instruments used during the NLF period confirms OVE's prior view that creating specific instruments adds little value to the institution. The major influence on such things as approval times and disbursement rates are either general changes to Bank procedures or idiosyncratic elements related to the particular situation in a particular country. Therefore, OVE would recommend:

- **First,** recognize that the changes to the general way loans are processed and the relaxation of many specific limits have already effectively done away with the problems for which "new instruments" had in the past been created. Continuing to differentiate multiple instrument types serves no useful purpose, and could quite probably contribute to a focus on the Bank's internal rules rather than the problems of client countries.
- **Second,** past experimentation with instrument diversification has turned up a number of promising innovations. These innovations should be generalized across the board rather than associated with the utilization of specific instruments.
- **Third,** building performance measurement into loans is also a useful technique that should not be confined to PDLs and Multi-phase operations. Flexible lending instruments were originally promoted as a way of encouraging greater focus on results. All loans in fact should focus on the specification of their intended results, even if results are not required to trigger disbursements.
- **Fourth,** the Bank urgently needs to address the issue of integrating disbursements with country systems. Disbursement problems are the leading cause of execution delays, and to date the Bank has not developed formal and transparent systems for identifying where and when it can rely on country systems for disbursement management.

IV. THE MOBILIZATION OF ANALYSIS AND KNOWLEDGE

4.1 Although most of the NLF recommendations relate to the Bank's lending program, the Governors also recognized that the mobilization of knowledge and technical expertise is an important part of the contribution the Bank makes to the Region's economic and social development. In fact, the NLF document notes that "*In the context of decreasing net financial flows from the IDB to the borrowing countries, the importance of the contribution to development that the Bank can make through these activities becomes critical*."

4.2 This Chapter will look at efforts by the Bank during the NLF period to strengthen the quality of analytical work and to enhance the contribution to development through technical cooperation activities. It will address two of the NLF recommendations: **Recommendation 10** to Strengthen analytical capacity and **Recommendation 9** to Strengthen IDB Non-Financial Products and Technical Assistance.

Recommendation 10:
Strengthen Analytical Capacity

The analytical underpinnings of Bank strategies, programs and projects should be strengthened in order to implement the recommendations presented above. This requires increased Bank capacity to carry out:

a. Economic and Sector Work (ESW);
b. Public Expenditure Reviews (PER);
c. Financial impact at the country level;
d. Project analysis (technical, economic, financial and institutional);
e. Country Financial Accountability Assessments (CFAA); and
f. Country Procurement Assessment Reports (CPAR).

Recommendation 9:
Strengthen IDB Non-Financial Products and Technical Assistance

Non-financial products and technical assistance should play a key role in the support the Bank offers to borrowing countries, particularly in the areas of institutional strengthening and reform. Developing analytical capabilities in local institutions and helping them achieve the standards required for the successful implementation of these recommendations should be given a high priority, which should be reflected in the Bank's programs, projects, and technical cooperations, including financial and non-financial products. In the context of decreasing net financial flows from the IDB to the borrowing countries, the importance of the contribution to development that the Bank can make through these activities becomes critical.

A. Strengthening Analytical Capacity

4.3 In evaluating this recommendation, OVE looked at each of the capacity areas outlined above to determine progress to date. Three of the recommendations (b. e. and f. above) deal with enhancing the Bank's capacity to produce certain types of technical analysis: public expenditure reviews, Country Financial Accountability Assessments, and Country Procurement Assessments. Each of these reports that had been produced by the World Bank prior to the NLF, and the Bank intended to cooperate with the World Bank in making these assessments in the future.

4.4 Table 4.1 shows the World Bank's production of each of these three instruments. It shows that the IDB participated as co-team leader in almost all of the CFAAs and CPARs, but in only a small portion of the Public Expenditure Reviews.

Table 4.1

World Bank Assessments		
Country	**Yr Approved**	**IDB co-team leader?**
Country Financial Accountability Assessments		
El Salvador	2004	
Guatemala	2005	Y
Honduras	2004	Y
Jamaica	2005	Y
Mexico	2005	N
Nicaragua	2005	Y
Panama	2006	Y
Paraguay	2004	Y
Uruguay	2004	Y
Country Procurement Assessment Reports		
Brazil	2004	N
Chile	2004	N
Colombia	2005	Y
Costa Rica	2005	Y
Dominican Republic	2004	Y
Ecuador	2005	
El Salvador	2004	Y
Guatemala	2005	
Honduras	2004	Y
Jamaica	2005	Y
Mexico	2004	
Paraguay	2007	Y
Peru	2005	Y
Uruguay	2006	Y
Public Expenditure Reviews		
Bolivia	2004	
Colombia	2004	N
Costa Rica	2008	Y
Dominican Republic	2004	N
Ecuador	2004	Y

Public Expenditure Reviews		
El Salvador	2004	N
Guatemala	2005	
Honduras	2007	N
Jamaica	2004	N
Mexico	2006	
Mexico	2005	
Mexico	2004	N
Panama	2006	
Paraguay	2005	N
Uruguay	2005	

4.5 There appear to be no cases in which any of these reports were produced entirely by IDB staff. From an evaluation point of view, it is impossible to assess the stated NLF objective of increasing Bank capacity in this area because all of the studies are joint products, and all follow the form and content of the World Bank. It should be noted in this context that the World Bank has moved away from these formal assessments, in favor a more integrated approach to public financial management, which emphasizes implementation rather than diagnosis. It is not clear from available evidence whether the Bank has also moved in the same direction.[46]

4.6 **<u>Financial Analysis at the Country Level</u>**. (item c. above) OVE has reviewed the quality of the Bank's financial analysis at the country level in the context of its evaluability reviews of country strategies. Looking at the quality of Bank diagnostics, the review found improvements in the macro-fiscal assessment and the treatment of debt. This is reflected by an average rating of 54 (out of a total of 100) for the question that deals with the macro-fiscal assessment. Still missing from the assessments, however, is the role of the Bank's lending –and in particular the different (high, low) lending programs on each country's debt profile and fiscal environment.

4.7 Also, it was observed that macro assessments still lack a strategic focus, meaning that in countries with more severe financial scenarios the debt assessment should be more extensive than in countries with less severe debt and fiscal environments. For example, countries with heavy fiscal challenges, such as Haiti and Jamaica, had relatively poor assessments. This finding mirrors what was reported by OVE in its prior review of Country Strategies. The Table below presents the prior CS review results by country, along with the degree of public finance challenge, based on macro aggregates and on data reported in the strategies themselves.

[46] See Management's response (Appendix H) to the World Bank's IEG Evaluation: "Country Financial Accountability Assessments and Country Procurement Assessment Reports. How Effective Are World Bank Fiduciary Diagnostics)"; April 25, 2008

Table 4.2
Public Sector Finance Challenge and OVE Rating of Macro-Fiscal Analysis, 2005 OVE Review

Country	Public Finance Challenge	Score (as a percentage of Maximum)
AR	Medium	7
BL	Medium	7
BO	High	0
BR	Low	33
CO	High	11
CR	Medium	33
EC	Medium	7
GU	Medium	17
PR	Medium	53
TT	Low	33
BH	Low	53
	Average LOW	34.44
	Average MED	16.28
	Average HIGH	5.50

4.8 According to the 2005 review "*The financial exposure analysis should be most prominent in countries in which the strategy identifies public finance as a top-level development challenge. That is not what was found. The two strategies that identified public deficits or debt as fundamental development challenges did little to address the issue of financial exposure analytically. In contrast, in cases where fiscal stability was less of a challenge, there was more analysis. From the above it is unclear what criteria Management is employing in prioritizing among sector work in country strategies, at least in the instances related to financial exposure.*"

4.9 **Project Analysis.** (item d. above) OVE has for some time been concerned about the quality of the economic analysis in the Bank's projects. RE-300 cited a 1998 study by the Bank's Controller that found only 57% of a sample of projects contained some form of cost benefit analysis, and that only a quarter of them "presented a good or acceptable analysis of the expected project impact." That report concluded that "no systematic efforts exist to promote a more consistent use of economic analysis in support of project design, appraisal and evaluation throughout the Bank."[47] OVE's own analysis found that roughly 39% of the loans reviewed (74 out of 190) made some mention of rate of return or cost-benefit calculation, and only a small minority of those could produce adequate documentation to support the analysis.

4.10 Because of these concerns, OVE's 2008 work plan included a study of the quality of economic analysis in projects. That study is being sent to the Board at approximately the same time as this NLF evaluation. Rather than duplicate the

[47] The Economic Analysis of IDB Financed Projects, Office of the Controller, March, 1998.p. iii.

analysis, this section of the NLF evaluation will simply summarize the findings and recommendations, since both documents can be considered by the Board within a short period of time.

4.11 OVE's 2008 study corroborates earlier findings that the quality of economic analysis in IDB operations is low. The sample used consists of 190 projects approved from 1997 to 2006, maintaining the composition by sector and by country of the Bank's loan portfolio. The evaluation focuses on the "economic analysis" in projects, which involves a weighing of costs and benefits, to value the consequences of a policy, a project, or other type of government intervention.[48][49]

4.12 The relevance of economic analysis for the Bank is that it has two properties that are essential for carrying out the Bank's mandate set out in its charter. The first is that economic analysis is a tool that makes it possible to attribute expected values to the objectives set forth in a project, and, therefore, that makes possible decision-making comparing alternative models of intervention. The second is that economic analysis can improve the performance of the Bank's portfolio whenever it provides valuable information on the optimal scale of investment, location, technology, and time of investment for a specific investment.

4.13 Two additional qualities that can be attributed to quality economic analysis are, first, that it imposes the discipline of stating, in measurable terms, the objectives expected to be attained through implementation of the project. And second, that it delimits the scope of the project objectives, on requiring that they be measurable, impeding the inclusion of overblown objectives, thereby leading to the design of an analytical framework for results-based management.

4.14 When undertaking the evaluation, OVE found a lack of a clear and unified set of rules in the Bank in relation to the quality of economic analysis demanded of projects. This lack of rules is in itself a troubling finding in light of the NLF objectives.

4.15 OVE developed a rating system which focused on eight dimensions to be evaluated: (i) the relationship between project objectives and economic analysis, (ii) the consideration of alternatives to the path chosen, (iii) financial analysis, (iv) cost-effectiveness or cost-benefit analysis, (v) fiscal impact, (vi) environmental impact, (vii) risk analysis, and (viii) institutional analysis. Each dimension of the tool has one or more evaluation criteria, resulting in a total of 14 criteria. A scale of 1 to 4 was used in the evaluation process (poor, fair, acceptable, and good) to score each criterion evaluated, and specific requirements were established for each of the scores of the different criteria so as to minimize subjectivity and maintain consistency among evaluations of different sectors and countries.

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[48] BOARDMAN, Anthony E. et al. *Cost-Benefit Analysis: Concepts and Practices*. 3rd ed. New Jersey: Pearson Prentice Hall, 2006.

[49] Limitations in the theory, the nature of the sector evaluated, or the availability of data and analytical resources may make it impossible for the analyst to measure and consider all the impacts of a policy. In those cases in which the impacts can be quantified but not valued, the preparation of a cost-effectiveness or minimal cost analysis will be required.

Table 4.3
Summary of Findings on Economic Analysis

Dimensions of the Economic Analysis	Criteria	Good %	Acceptable %	Regular %	Poor %	Average (From 1 to 4, 4 is the highest score)
Objectives	Objectives and Economic Analysis Relationship	24.7	1.8	3.6	69.9	**1.813**
Alternatives	Counterfactual Analysis	2.4	5.4	7.8	84.3	**1.259**
	Identification and Evaluation of Alternatives	2.4	4.2	9.6	83.7	**1.253**
Financial Analysis	Estimation of Financial Flows	2.4	1.8	5.4	90.4	**1.163**
	Debt Sustainability Analysis	0.6	1.8	13.3	84.3	**1.187**
C-E or C-B	Cost Effectiveness Analysis	1.2	6.0	10.2	82.5	**1.259**
	Cost Benefit Analysis	3.0	22.3	13.3	61.4	**1.669**
Fiscal Impact	Identification of Fiscal Impact	0.0	11.4	59.0	29.5	**1.819**
Environmental Impact	Inclusion of Environmental Impact	0.0	0.0	2.9	97.1	**1.029**
Risk Analysis	Sensitivity Analysis	1.2	11.4	13.3	74.1	**1.398**
	Switching Value analysis	0.0	0.0	0.6	99.4	**1.006**
	Variables to Monitor and Mitigation Measures	0.0	0.6	0.0	99.4	**1.012**
Institutional Analysis	Stakeholder's Analysis	0.0	5.4	87.3	7.2	**1.982**
	Institutions Involved and Mitigation Measures	6.0	4.2	49.4	40.4	**1.759**

4.16 The results shown in Table 4.3 indicate that there is still considerable room for improving the quality of economic analysis of the Bank's interventions. If one excludes policy-based loans from the analysis, one finds that 46.4% of the sample presented some type of economic analysis (cost-benefit or cost-effectiveness). This figure is approximately the same as that found in the 1998 Controller's study and OVE's 2004 review. Little change is therefore observed on the share of projects containing any type of economic analysis.

4.17 When the quality of the analysis is measured, one observes that only 7.8% of the projects with cost-benefit analysis and 6.9% of those with cost-effectiveness analysis attained the highest score in the evaluation. Indeed, more than one-third of the projects with cost-benefit analysis showed just a number for the internal rate of return, without any analytical justification. In addition, more than half of those with cost-effectiveness analysis indicated that the project was done with least cost, or was cost-effective, but made no mention of the alternatives. Since "least cost" is a comparative measure, the lack of discussion of alternatives severely compromises the quality of the analysis.

4.18 Another critical quality dimension is the analysis of risk, in particular, sensitivity analysis. A sensitivity analysis tests the project's anticipated return in a variety of future scenarios, to estimate how likely it is to be resilient in the face of materialized risk. Of the total number of projects with cost-benefit analysis, 64.1% performed a sensitivity analysis, while 34.5% of the projects with cost-effectiveness presented such an exercise. Only two projects received the top score. The most frequently used technique was the arbitrary introduction of variations (from 10% to 25% in most cases) in the projects' total benefits and costs. This produces a range of values, but does not in fact demonstrate any analytical understanding of the risks involved.

4.19 As regards the relationship between the project objectives and the explicit benefits in the cost-benefit or cost-effectiveness exercise, a score of "good" or "acceptable" was given to just over one-fourth of the projects evaluated. In addition, the results reflect the lack of alternatives, both of a counterfactual scenario and of interventions that constitute alternatives to the project evaluated; this is a characteristic trait of more than 84% of the projects reviewed, a figure similar to that found in the case of analysis of the capacity for indebtedness within the criterion of financial analysis. A somewhat more favorable situation is observed in the identification of the fiscal impact on the players involved in the project, with respect to which 11.4% of the projects were categorized as acceptable and 59% as fair.

4.20 In terms of environmental impact analysis, a binary score was given, depending on whether the environmental costs and benefits had been included in the economic analysis. The study revealed that more than 97% of the projects had a poor score since in most cases the environmental costs derived from the impact study were not incorporated in the cost-benefit analysis.

4.21 The last dimension evaluated had to do with the institutional analysis. The criterion of description of the stakeholders obtained a score of good or acceptable in just over 5% of the cases, whereas that ratio was 10.2% for the criterion of identification of the weakness of the institutions and mitigation measures.

4.22 To explore the reasons for this generally disappointing performance, OVE conducted a survey of Bank staff, supplemented by interviews with Bank officers and government officials. The principal explanations cited were: (i) the lack of a complete and specific set of rules or guidelines for the economic analysis of projects financed by the Bank; (ii) weak *economic and sectoral work*; (iii) the lack of recognition for staff doing quality analytical work; (iv) the disconnect between the quality of the portfolio and the Bank's credit rating; (v) the preponderance of sovereign risk in the loan portfolio; and (vi) the organizational separation between project design and project implementation.

4.23 In effect, one of the causal factors considered most relevant is the lack of an appropriate normative framework so as to foster a quality economic analysis. The quality standard explicit in the requirements set forth in the Bank's rules is excessively generic and lacking in specificity. A much more explicit standard had been in existence since 1981 (OP-302), but these standards were replaced in the mid 1990s by much looser guidance to project teams as to what was required of economic analysis in projects.

4.24 Another cause that explains the low quality of economic analysis is the Bank's weak economic and sectoral work (see below). As a result of these shortcomings, little in-depth knowledge is disseminated in the institution with respect to the economic sectors and borrower countries served by the Bank's loans. This makes it difficult for project teams to design interventions; these teams must select the most profitable intervention, in economic terms, based on the knowledge acquired and the information available.

4.25 In addition, the incentives structure for project teams favors the expeditious approval of loans, which, in light of the results obtained by this evaluation, has worked against the quality of the economic evaluations that certify such designs as the best use of available resources. Moreover, the divergence in time between the actions of those who design projects and the materialization of the results of their execution makes it difficult to structure a scheme of remuneration tied to development results.

4.26 The continuing pattern of weak economic analysis means that too few Bank interventions have an adequate evidence base for the hypotheses embedded in the project and thus cannot build robust results frameworks. This weak analysis fundamentally undermines any effort to "manage for results". Among the main recommendations stemming from this evaluation, the following merit special mention: (i) establish a normative framework that makes it possible to design and supervise a quality economic analysis, (ii) get the institution's incentives, in terms of recognition of staff, to be geared to fostering quality projects more than quantity of projects, and (iii) strengthen the sectoral economic analysis as a strategic foundation for preparing quality projects.

B. Economic and Sector Work

4.27 At the end of 2006, OVE presented to the Board a review of Bank studies. These were defined as: *"a written document that is intended to create and/or disseminate knowledge. Studies are the final output of analytical activities. They present data and advance hypotheses regarding the causes of development problems and the possible interventions that might contribute to their improvement."* These characteristics are virtually identical to what the World Bank calls "economic and sector work" (ESW).

4.28 RE-323 found substantial problems with the way the Bank plans, organizes, tracks, controls quality, disseminates and uses the information produced in studies. The report made recommendations in each of these areas, recommendations which both Management and the Board supported.

4.29 In light of this earlier work, this section of the NLF evaluation will examine follow-through on the recommendations made in RE-323. In general, OVE finds some encouraging signs of improvement in a number of areas, but with substantial problems still remaining to be addressed.

4.30 **The Programming of Studies**. To be effective, studies must be clearly connected to current problems in the Region. For the Bank, the place where problems are connected to potential solutions is the programming process, and thus a key recommendation of RE-323 was to articulate clearly in each country strategy paper the areas where further study is needed.

4.31 Progress in this area has been mixed. OVE's evaluability assessments rate the quality of sector work in country strategies, and these assessments have found improvement from 35% to 45% of the total possible score for the more recent strategies. The presence of sector work is seen in better descriptions of the macro environment (borrowing heavily from IMF and other assessments), in some cases better assessments of poverty, and an increased emphasis on assessing the political environment.

4.32 Despite this progress, there are still significant issues with respect to programming analytical work. First, at the sector level, strategies rarely provide a basis for the programming being proposed. That is, the consistency between programs at the sector level and analytical work is poor. This is seen clearly in the case of El Salvador, where sectors that will be central to the Bank's program, such as transportation, water, and technical education, have no diagnostics developed.

4.33 A second problem identified is the lack of a rigorous conceptual basis for the sector work being developed. This is particularly true in areas such as competitiveness, where the lack of sector work at the conceptual level leads to the absence of a clarity regarding what is to be achieved or how to achieve it. Lastly, the production of IDB-financed sector work still is not strategic. In other words, it is not clear that the sector work being produced by the IDB (as opposed to sector work from other agencies and sources) is being deployed to cover the gaps in the knowledge base regarding specific sectors or problems.

4.34 The lack of a strategic vision of sector work is also evident when assessing the Bank's future sector work program with each borrowing country. The review found that most strategies mention sector work and its importance. However, they do not integrate these studies into the strategic approach. Only three of 11 strategies attempted to indicate how studies would be useful, and in these cases only partially. Rather, strategies usually either list studies in an annex or list them as part of the results framework matrix.

4.35 Finally, there is little evidence of improved incorporation of country demand into the programming of studies. None of the strategies approved between 2005-08 contained any form of need or demand assessment. (See Table 4.4)

Table 4.4
Sector Work in Bank Country Strategies: 2005-2008

Country	Sector Work Mentioned	Incorporated in programming	Needs or demand assessment
Barbados	None	No	None
Chile	Annex	No	None
Colombia	RF, Annex, some text	Partial	None
Costa rica	Annex	No	None
Dominican Republic	RF, Annex	No	None
El Salvador	RF, Annex	No	None
Haiti	RF	No	None
Jamaica	RF, some Text	Partial	None
Peru	RF, Annex, some text	Partial	None
Panama	RF, Annex, some text	No	None
Uruguay	Some text	No	None

4.36 Programming of analytic work also takes place internally, and in this area OVE has also observed progress. In 2006, Management proposed an Initiative to Support Country Studies and Improve and Expand Bank Loan Operations (GN-2381-1). As part of this initiative, a Committee for Country Studies (CEP) has been established. The CEP has devised a process that includes peer reviews of the technical quality of studies (a recommendation of RE-323), as well as reviewing the relevance of studies for the preparation of country strategies, technical assistance and country dialogue. Thus far, 85 studies have been approved by the CEP process, although only 52 have formal CEP minutes posted.

4.37 While these developments are clearly positive, the CEP initiative affects only a part of the Bank's economic and sector work, and OVE can find no evidence of significant improvement regarding the studies produced outside CEP. The overall number of studies completed, 160 in 2006 and 92 in 2007, indicates that more than half of the studies remain outside CEP review. Furthermore, it is possible that proposed studies rejected or not submitted for review by the initiative could be financed by alternative means – consequently limiting the impact of the initiative. This concern is particularly critical for 2008 when there is a pipeline of more than 600 proposed studies on the OPUS system.

4.38 **Budgeting and Monitoring of Studies.** RE-323 recommended activity-based budgeting for studies, with each study having a unique code to which budget resources were attached and expenditures posted. Here again, there has been progress, but with a substantial unfinished agenda. Currently, each study has its own OPUS code, all costs are theoretically charged to the corresponding activity, including staff time and cost.

4.39 Despite this progress, the system is still not being utilized as designed. An analysis of the 2008 implementation of this system found a total of 862 studies with unique OPUS codes. Of these, 261 were budgeted (indicating intent), and 229 had expenditures (indicating actually expended effort). But only 65 had both budgets and expenditures. Almost never was staff time budgeted ex-ante, although there was evidence that a significant number of staff hours were being reported ex-post. However, it was also observed that a significant number of projects had positive expenditures and zero expenditure of staff time.

4.40 Finally, an analysis of the projects approved in 2008 under the Country Studies Initiative reveals that 8 projects have been approved and a budget of $1,456,250 allocated. However, reviewing the approved projects on OPERA we found that only $318,264 has been allocated to budget, and a total of $452,566 spent. As in previous projects, we found no budget allocation for FTEs.

4.41 **Quality Control of Studies.** RE-323 noted an almost complete absence of a Bank wide system for controlling the quality of studies. This issue has been addressed in the CEP initiative, which requires that proposals submitted to the Committee incorporate a list of candidates for the role of peer reviewers. To identify potential peer reviewers, the Secretary of the CEP made an external call for candidates. All those candidates have been registered in an electronic data base. Each proposal submitted to the CEP lists three potential peer reviewers, following the guidelines established for that purpose. The proposal's Budget includes $800 if the study merits "review and approval" by an external peer review or $500 if the study only merits review. Again, this system of quality control only applies to the minority of Bank studies that pass through the CEP process.

4.42 Related to quality control is the issue of internal incentives for the production of high quality studies, which was found to be weak in RE-323. In recent months, both RES and INT have defined strategies to recognize and reward quality work in the preparation of quality studies. These experiences include an incentive in the form of sabbatical weeks to be dedicated to the work with an academic institution of the staff member's choice. OVE is not aware of similar efforts in those organizational units dealing directly with the operational program where many of the Bank's studies are concentrated.

4.43 **Storage and Dissemination**: Analytical work is useful only if people working on interventions can find it. Acknowledging that Bank systems had not done a good job with this task, the 2007 capital budget included funds for a Knowledge Repository. The budget includes funds for a Taxonomy component, which will develop a common IDB vocabulary to classify relevant knowledge produced by the Bank and a metadata component, which will adopt an international standard to assure consistency and accessibility of data.

4.44 While this initiative is welcome, progress to date has been slow. Of the 160 studies completed in 2006 only 59 are available in IDBDocs, of the 92 studies completed in 2007 only 28 are available in IDBDocs. Of the 23 studies approved under CEP for 2006 only 13 are available in the web site of the initiative and as few as 4-6 can be found in IDBDocs. For 2007, 27 out of 53 studies are found in the web site of CEP and 6-7 on IDBDocs. While the CEP initiative fares significantly better, the Bank continues to underperform in regard to posting the completed studies for access within the Bank.

4.45 The results are significantly worse in regard to posting the completed studies in the internet. Only 18 (11%) of the 160 studies completed in 2006 were posted in the internet, while only 7 (8%) of the 92 studies completed in 2007 were posted in the internet. Only 3 out of 76 CEP completed studies were posted were posted for the internet. The difficulty of finding completed reports within the Bank Intranet remains related to lack of common agreements on standards for metadata, in particular how to classify different types of documents and studies. Different department guidelines and inconsistencies in the implementation of the existing guidelines on how to generate the metadata for studies increase the cost of searching, as well as become constrains to the dissemination of studies in the internet.

4.46 **Utilization**. RE-323 found limited use of many of the Bank's studies by the Bank's own project teams. A frequently-cited reason for this was the inability to search the Bank's databases effectively for studies related to a particular problem, and OVE recommended significant improvements to the Bank's internal search engines.

4.47 Within the Knowledge Repository Project, a multi-departmental Search Engine Committee was created in October 2007 to identify the Bank's needs regarding the current search engine and location of information and knowledge in the different Bank information systems. RES has developed customized reports and tools which link the studies data with their financial information and status. All systems are in place to allow the Bank to achieve standardization, a common navigation button in all Bank Internet web pages, and a permanent link (through IDBDocs) for effective and efficient searches of all studies on the IDB Internet web pages.

4.48 While there has been some progress, two critical issues remain largely unaddressed: 1) although standards exist for proper cataloguing of documents within IDBDocs, there is no authority to ensure compliance. 2) Effective search engines have not yet been implemented.

4.49 The choice and implementation of an adequate search engine within the Bank intranet web site remains outstanding. It was one of the main weaknesses identified in the original RE-323 analysis, and progress has been surprisingly slow. There are currently three different search engines working in the Bank. The ones in the Internet page and in the MyIDB Portal are administered by ITE, and the Google in the LRN website is managed by KNL department. Each yields different results in response to the same query, and there are substantial variations with respect to the ease of querying.

4.50 Finally, there has been no progress on resolving the problem having different IDBDocs libraries at Field Offices that are not integrated on-line with the IDBDocs version running at Headquarters. This continues to create significant obstacles for the task of findings studies that are produced by the Field Offices.

4.51 **Conclusion**. The Bank remains structured mainly to provide Financial Products. There is still no overall framework for the production of studies and there is an overall lack of organization and incentive structure to support NFPs and studies more broadly. These weaknesses are particularly reflected in the processes of hiring, budgeting and the management of the Bank products, where studies remain unprioritized and are given inadequate support and quality control.

4.52 Significant structural problems also persist. The lack of online integration of the libraries of Field Offices and Headquarters within the IDBDocs runs counter to the objectives and processes underlying the Realignment. There is no project cycle specialized in OPUS specifically for Studies, and OPUS does not have the capability to upload documents across stages of the project cycle.

4.53 OVE has observed some progress on implementing the recommendations of RE-323, but in virtually all areas, progress has been only partial. Some notable weaknesses continue to persist: (a) there is no evidence that most studies are strategically chosen; (b) most studies are not peer-reviewed for quality standards either at conception or at completion; (c) completed studies are often not found and seldom released for internet distribution; (d) utilization is generally not tracked; (e) there no common standard for metadata for studies; and (f) there is still no common and effective search engine to find the studies produced by the Bank.

C. Technical Assistance

4.54 NLF recommendation 9 stresses that technical assistance should play a key role in the support the Bank offers to borrowing countries, particularly in the areas of institutional strengthening and reform. Developing analytical capabilities in local institutions and helping them achieve the standards required for the successful implementation of these recommendations should be given a high priority, which should be reflected in the Bank's programs, projects, and technical cooperation, including financial and non-financial products. In the context of decreasing net financial flows from the IDB to the borrowing countries, the importance of the contribution to development that the Bank can make through these activities becomes critical. This endeavor has always been fundamental to the Bank. Indeed, providing technical assistance was one of the five major functions assigned to the Bank by its Charter, which defined this function in the following terms:

> *(v) to provide technical assistance for the preparation, financing, and implementation of development plans and projects, including the study of priorities and the formulation of specific project proposals.*

This description placed TC activities "upstream" in a country's development process, by focusing on planning and prioritization. TC was seen to be a mission-critical activity by the Bank's founding shareholders, who devoted Article VI of the Charter to identifying the goals and methods for this instrument.

4.55 Yet despite the importance attached to technical assistance in the Charter, the Bank's actual practice has severely limited both the scope and focus of this activity. TC activities have historically involved between 1% and 2% of total Bank approvals, and the focus of TC activities has been on the implementation of Bank loans rather than the broader planning and design of development approaches envisioned for this activity in the Charter.

4.56 The Bank's actual practice has also moved the focus of TC "downstream", concentrating on the execution of projects via the provision of small grants - usually on a non-repeat basis - scattered among a myriad of executing agencies. Bank practice has aimed for breadth at the expense of depth, attempting to reach many institutions with short-term financial support, rather than building long-term capacity at fewer strategic partners. This evolution has created an enormous managerial challenge simply to keep track of the volume of TCs in preparation and execution, a challenge indicated by the data in Table 4.5.

Table 4.5
Technical Cooperations (as of July 28, 2008)

	IN PREPARATION		IN EXECUTION	
	Number of entries	**Number of entries budgeted**	**Number of entries**	**Number of entries budgeted**
ICF/102	0	0	1	0
ICF/CMF	25	3	67	16
ICF/FMM	31	11	62	18
ICF/ICF	2	0	2	0
ICF/ICS	38	9	203	62
INE/103	0	0	0	0
INE/300	0	0	0	0
INE/CNI	0	0	0	0
INE/ENE	44	23	69	22
INE/INE	15	4	13	1
INE/RND	30	14	160	37
INE/TSP	23	7	57	26
INE/WSA	19	9	67	25
INT/001	0	0	0	0
INT/EUR	0	0	0	0
INT/INT	54	18	121	5
INT/ITD	0	0	1	0
INT/RTC	0	0	0	0
SCL/004	0	0	0	0
SCL/010	0	0	0	0
SCL/CVE	0	0	0	0
SCL/EDU	21	9	54	13
SCL/GDI	8	2	55	3
SCL/SCL	2	1	1	0
SCL/SCT	18	5	41	8
SCL/SPH	46	17	210	52
Total	**376**	**132**	**1,184**	**288**

4.57 This section of the NLF evaluation is based on two large evaluations of technical cooperation activity performed by OVE over the past few years. Both were carried out at the request of specific funders of TC activities, the Multilateral Investment Fund (MIF) and Japanese Trust Funds (JTF). The MIF evaluation reviewed more than 500 projects totaling $800 million, while the JTF evaluation examined 129 TCs totaling $71 million[50]. These two evaluations focused on the

[50] The methodology was compatible with that utilized for the MIF, expanding the assessment to ten key evaluative dimensions: (i) relevance, (ii) effectiveness, (iii) efficiency, (iv) innovation, (v) sustainability, (vi) additionality, (vii) visibility, (viii) monitoring and evaluation, (ix) internal control, and (x) lessons learned.

three key institutional objectives set for technical assistance:(i) preparation, financing, and execution of development plans; (ii) preparation, financing, and execution of projects; and (iii) institutional capacity building in member countries.

4.58 **Preparation, Financing, and Execution of Development Plans.** The contribution of the Bank in this area revolves around three key competences: (i) needs assessment, (ii) technical contribution, and (iii) procedural support. Although the Bank potentially enjoys comparative advantages in all these areas - due to its convening power in the Region, technical expertise and the strength of some of its administrative procedures; evidence so far indicates that the Bank has failed to systematically deploy these advantages due to weaknesses in its system to manage technical assistance.

4.59 **Needs Assessment.** Evidence from prior evaluations indicates that technical assistance at the Bank has consisted of isolated efforts, disconnected from a comprehensive assessment of beneficiaries' needs, priorities and demands. As a result, outputs produced by TCs were routinely not integrated into the Bank's overall sector knowledge; and thus did not advance comprehensive development plans and agendas.

4.60 For example, it was found that TA "intervention[s did not have] a shared, accessible, timely diagnostic study around which the activities could be organized" (MIF). Furthermore, "only 50% of the TCs involved final beneficiaries in design and/or execution activities. As a result, 43% of the TCs failed to identify the critical needs of the final beneficiaries, resulting in decreased relevance to them" (JTF).

4.61 The review of project design (ex ante) showed that on average three out of four TC projects evaluated were carried out in areas considered highly relevant by beneficiaries in the countries. However, "a specific link could not always be established between a project and a given problem, because most of the projects did not have an adequate assessment or solid analytical foundations that would justify intervention in a particular context" (MIF).

4.62 **Technical Contribution.** Evidence from the evaluations also indicates that TC activities at the Bank have been scattered. As a result, technical assistance has lacked the focus and concentration that might have enhanced the technical value provided by the Bank, particularly in the areas where the Bank has a proven track record of expertise and/or comparative advantages.

4.63 The evaluations found that "the most successful … interventions were correlated with concentrated activities in a given area, thereby achieving a critical mass of resources, with a sequencing of activities and a strategy over at least the medium-term horizon" (MIF). Its most significant results have been in those segments in which niches were identified where the MIF activities proved highly complementary to Bank efforts and capacities.

4.64 It was found that "intervention[s] would have required greater emphasis on identifying niches where MIF activities would be relevant" (MIF). Similarly, "MIF additionality was more difficult to ascertain in areas involving a large number of parties and that were less likely to have a clear strategic direction" (Pg 10, MIF). Additionality was higher when the MIF supported specific, technical activities often overlooked under major reforms, such as consumer protection.

4.65 Overall, the Bank "lacked capabilities to assess the content of [TA] operations and integrate them with other initiatives at the Bank. In fact, only 55 % of the TCs showed any kind of interaction with similar initiatives in or out of the IDB" (JTF). Similarly, "since each JTF project was managed in relative isolation, any potential additionality afforded by stronger coordination with other related initiatives - at either the IDB or at other Japanese official development assistance agencies - has been reduced" (JTF).

4.66 **Procedural support of the Bank.** The IDB could play an important role not only in convening development actors from both the public and private sectors, but also in helping implement best practices regarding the preparation, financing, and execution of development plans. The evaluations show that the Bank has naturally brought to bear "several value added characteristics … already embedded into [its] culture and procedures, e.g., discipline for spending control, attention to environmental and social aspects, or emphasis on participatory community processes" (JTF). However, the Bank has been less proactive in identifying and disseminating other procedural best practices more specific to the national planning processes.

4.67 The evaluations found that "the value added by the Bank/MIF in the operations was mainly geared towards the project preparation stage and gradually declined during project execution, when the emphasis is placed on administrative procedures and not on technical support for the innovations" (MIF). The evaluation showed a need for greater technical support during execution. Despite the high degree of commitment ascertained, "the support offered by the Bank's Country Offices did not necessarily include in all cases the technical specialization needed" (MIF).

4.68 In the JTF case, project additionality was defined largely in financial terms. In only 47% of projects was there "evidence that the TC design included any action to enhance value-added" (JTF) - thus hampering the Bank's ability to actively deploy any procedural best practices via its TC activities.

4.69 **Preparation, Financing, and Execution of Projects.** The contribution of the Bank towards the preparation, financing, and execution of projects revolves around three key competences: (i) project optimization, (ii) risk management, and (iii) quality of outputs. The evaluations conclude that the Bank has disproportionally focused its attention on project preparation (optimization), in detriment of the other two areas: risk management and quality of technical outputs. Furthermore, despite its emphasis on project preparation, the evaluations found no statistically significant evidence that the Bank's technical cooperation has systematically succeeded in preparing better projects - as measured by their evaluability indices and execution times.

4.70 **<u>Project Optimization</u> -** Despite its much smaller size, technical assistance has been plagued by the same types of delays affecting the Bank's lending program. Instead of leveraging the different nature of technical cooperation, particularly its potential to set agendas and introduce discipline into the implementation schedule of national investment projects, the Bank has managed technical assistance mostly like smaller financial operations subject to the same limitations as its loans. In fact the concept of technical assistance as a small project, with a defined beginning and end, is inconsistent with the evidence regarding the need to sustain technical assistance and advisory services on a more permanent basis.

4.71 Despite the fact that TA activities were meant to optimize project planning and execution, they themselves suffered from poor project management performance. For example "about 89% of the JTF operations evaluated exceeded their estimated execution time, including 37% exceeding their estimated time by at least 50% and 18% taking twice as long or longer to execute. Although reporting on budget changes during execution is scant, the evaluation found that delays meant that TCs required 40% more resources in order to continue supporting the [overhead costs of the] executing agencies during the additional execution time (JTF).

4.72 The most decisive factor in inefficiency in the use of resources was delays in project execution, which increased the proportion of administrative expenses, usually at the expense of other budget items associated with the provision of services. In addition, the MIF policy to avoid financing second stages has led to the design of very complex projects that are difficult to manage efficiently. In prior evaluations "such delays reveal a need to recognize that properly configuring regulatory and institutional frameworks is a lengthy process that is better supported through gradual methods that may require sustained assistance either from the MIF or other interested parties" (MIF).

4.73 A consistently striking observation in all the project groups evaluated was that it took two years from project registration to the last disbursement, even in the case of lines of activity, which had helped reduce approval times by 60%. Forcing a *project approach* to the solution of those issues has only exacerbated so called "structural factors linked to project preparation, approval, signature of the agreement, and fulfillment of the conditions for eligibility for disbursement that cause delays and have resisted various attempts to streamline the process" (MIF).

4.74 Prior evaluations also suggest that TA activities "did not produce a significant difference in [loan] quality. About 74% of the loan preparation grants succeeded in leading to the approval of the respective IDB loans. However, it is unclear to what extent - if any - the JTF contribution has made a difference in terms of the quality of the loans produced. Given the generalized lack of impact studies and the short time elapsed, it is not possible to compare the long-term development effectiveness of loans produced with the JTF compared with similar loans that did not received that support. However, OVE utilized the quality of the loan design and execution - for example, evaluability indexes and execution speed indicators - as proxies, and found no statistically significant difference as a result of JTF participation" (JTF).

4.75 **Risk Management.** Technical assistance has also suffered from very weak risk management, as well as an inability to utilize lessons learned to improve future projects. These characteristics applied not only to the TCs themselves, but also to their ability to manage risks related to the investment projects they were supposed to help prepare. It was found that the Bank lacks a system and an organization to accumulate relevant experience and effectively bring it to bear in risk mitigation activities. This inability is particularly acute in terms of delivering effective risk mitigation on an on-going basis - particularly over the extended period required by some interventions.

4.76 For example in the MIF evaluation, it was recommended that the MIF "reexamine the incentives that in the past have led to superficial treatment of the key problems to be resolved and a significant underestimation of risks in project documents" (MIF). Similarly, it was found that "TCs were weak in their application of mechanisms to secure the achievement of results. For example, 51% of the TCs failed to utilize mechanisms to identify and mitigate key risks, which in turn affected the achievement of results. Risk mitigation, or lack thereof, also led to some sub-optimal results in approximately 55% of the TCs" (JTF).

4.77 With regards to monitoring and evaluation, only one third of the projects were able to meet adequate evaluability standards. Given the experimental nature of the operations, their design should help ensure monitoring and measurement of outputs and outcomes, in order to facilitate the drawing of lessons learned. For example "midterm and final evaluations, which are vital to allow adjustments to be made in project execution and lessons learned, were not widely used, because in many cases they were not easily accessible for broader learning … There was little effort to assess project impact, particularly at the end beneficiary level" (MIF).

4.78 **Quality of Outputs**. Similarly, there is little evidence to suggest that the Bank has an adequate system to guarantee and enhance the quality of the outputs produced via technical assistance activities. The evaluations suggest that TCs at the Bank substantially produce the number of outputs planned. However, there is no established system to check the quality of those outputs and share them with a wider audience of technical experts.

4.79 The evaluations confirmed that IDB personnel had a tendency to give a lesser priority to managing NRTC, while concentrating their best efforts in the management of larger loan operations. In fact "the quality of the products delivered by the TCs has remained unverified and potentially exposed to unmitigated levels of risk, despite their overall achievement of results. The system focused on controlling financial and quantitative aspects, but lacked the technical ability to independently verify quality. (JTF).

4.80 A lack of standardization of TC outputs was evident from the fact that "only 54% of TCs had a plan of operations with clearly specified activities - Observed a high disparity in "unit costs" of similar studies (a range of almost 300%). [In addition] costs per activity were taken from the budgets submitted by the TC recipients without any evidence that their feasibility was systematically checked against comparable benchmarks. Furthermore, once budgets are approved there is no incentive to find additional savings during TC execution" (JTF).

4.81 Self-evaluation systems and methodology are rarely applied. For example, Project Performance Monitoring Reports, which in theory are required for larger JTF operations, were either left blank or just cursorily completed. "A majority of the evaluated TCs (80%) lacked a logical framework stating indicators and targets to measure achievement. There was also a widespread lack of baselines and targets (for about 50% of the TCs). As a result, the follow-up of JTF operations was lax, focusing on administrative issues and lacking consistency and depth for judging the quality of results" (JTF). "Only 38% of the TCs planned any type of monitoring or self-evaluation activity. No independent monitoring and evaluation system" (JTF).

4.82 An overall problem that affects all the stages of the TC, including design, monitoring, and evaluation, is the dispersion and in many cases the lack of key documentation related to the TCs and the information stored in the information technology systems of the IDB. "Collection of documentation and data was contingent on what was available either at IDB field offices and/or executing agencies, on Web searches, and interviews at headquarters. In this regard, there were almost no ex-post impact evaluation studies on hand, even when mandated by the IDB rules. Some information was not documented in the corresponding data gathering and storing systems of the IDB, although it was also mandated. Of the evaluated TCs, 17% had a final report available for review and only 8% had an independent final or mid-term evaluation available" (JTF).

4.83 **Building Institutional Capacity in Member Countries**. The contribution of the Bank in this area revolves around three key competences: (i) long term commitment with key executing agencies, (ii) human resources and organizational development, and (iii) best practices and innovation. The evaluations conclude that the Bank has operated its technical cooperation program in a way that is not conducive to nurturing the institutional capacity of key executing agencies in the borrowing countries. TC at the Bank has been focused on producing short term outputs (e.g., studies); rather than longer term outcomes related to the development of human resources and organizational capabilities.

4.84 **Long-term Commitment with Key Executing Agencies**. Prior evaluations show that technical assistance was more likely to have an impact when structured as long-term relationships with selected executing agencies in the countries. However, evidence suggests that the Bank has so far lacked the concept of long-term, strategic partnerships with key executing agencies. TC projects are structured as short term engagements averaging two years; and follow up support to executing agencies is usually discouraged, unless there is a TC or loan under execution.

4.85 The evaluations found that the selection and long term nurturing of executing agencies has been key to success. In fact "executing agency maturity and operating capacity was one of the most decisive factors in project success or failure" (MIF). In fact "most of the sustainability problems were associated with:

(i) a lack of institutional analysis of the executing agencies… (ii) the transition from MIF funding to new sources of income or financing for the products and services developed; and (iii) MIF project isolation from broader programs, including Bank programs, or from national policies that could have lent continuity to the financing initiated by the MIF" (MIF).

4.86 Sustainability was largely enhanced by the involvement of diverse stakeholders such as the local government, private sector, and local civil society organizations. It is worth noting that 54% of the services/outputs produced were successfully sustained after the completion of the TCs. However "*sustainability* seems to have been obtained *ad hoc*, as there is no evidence that the JTF utilizes standardized criteria to select, monitor, and nurture executing agencies" (JTF).

4.87 **Human Resources and Organizational Development.** Capacity building is ultimately embodied into human resources, organizations and procedures residing in the respective countries. The evaluations found that since a majority of the technical outputs were produced with the help of short-term, external consultants, there were shortfalls in the technical expertise transferred to the executing agencies. Furthermore, the Bank TCs have been lax in their dissemination of organizational best practices that could have enhanced the sustainability of executing agencies.

4.88 The evaluations found that expertise often resided within "a core group of specialized consultants in innovative areas in the Region" (MIF). In securing that expertise "duplication in spending could not be prevented for the same type of services, which were often provided by the same consultants in different countries" (MIF). Furthermore "although the objectives and activities of the projects were similar in different countries, there was very little communication and almost no exchange of experiences between projects" (MIF).

4.89 The evaluations concluded that "by developing central registries for specialized consulting services with performance ratings, standardized information systems, or specific procedures for international competitive bidding, MIF-financed products could more easily be used multiple times. Procurement could be carried out jointly so that economies of scale could be achieved, or components such as information systems, teaching materials, manuals, dissemination, and similar items could be shared" (MIF).

4.90 **Best Practices and Innovation.** Capacity building hinges upon the ability to identify best practices and incorporate lessons learned. Similarly, it requires a capability to foster innovation and deploy it according to the needs of each country and executing agency. Evidence from the evaluations points to weaknesses of the Bank's systems to capture best practices and foster innovation. Although some innovations are produced ad-hoc, there is no evidence that they are the result of a specific system, or incentives geared towards their promotion.

4.91 For example, the evaluations found that "only 11% of the TCs show evidence of utilizing past *lessons learned.* In fact, the lack of utilization of lessons learned is a common problem in all of the IDB's NRTC, as there is no system for sharing lessons developed in the past, and no central location to store and retrieve them.

For example "there is no evidence that at the time of project approval, the JTF goes through a systematic checklist of past lessons learned" (JTF).

4.92 "Many TCs (49%) produced innovative elements, however, these were ad-hoc and not adequately disseminated… Innovations depended heavily on the individual abilities of the consultants hired [due to a lack of a mandate and], not on a deliberate effort by JTF to foster innovation. In fact, JTF managed activities on a project-by-project basis, thus having little ability to sequence them to produce research and development activities on new types of development interventions" (JTF).

4.93 Evaluative evidence shows that the role of technical cooperation in strengthening institution's long-term planning capacity has been weak. A tendency to overlook an assessment of sector needs and a weak involvement of final beneficiaries has produced partial diagnostics that have been unable to justify the Bank's interventions, and link them with related initiatives. Furthermore, the Bank has been generally unable to utilize technical cooperation to generate standardized procedures that could infuse a discipline and a quality seal on the related investment programs.

4.94 Similarly, there is no evidence that the use of technical cooperation had produced significant improvement in the quality of the project preparation, as measured by project evaluability and delay indexes. Technical cooperation was also generally unable to produce a significant improvement in risk identification and mitigation, and lacked a system to utilize lessons learned to improve future projects. Even the quality of the technical outputs produced, remained unverified and exposed to a great variability in terms of unit costs.

4.95 **Reforming Technical Cooperation**. In 2008, the Board of Executive Directors approved a change in the Bank's policy on technical cooperation. To a considerable extent, the changes reflected the lessons discussed above. The new policy located TC as part of the Bank's programming process in a country, and thus potentially more "upstream" in a country's development process. It requires that TC projects have clearly specified results frameworks, and meet standards for evaluability.

4.96 While the new policy clearly represents a step forward for the effective use of TC within the Bank, there remain some issues which the Bank may need to consider as it moves to implement the new policy.

4.97 First, it is easier to imagine change than to do it. Problems with technical cooperation were noted in the 1994 IDB-8 agreement, and solutions were proposed then that incorporate some of the concerns of the new policy change. Of particular interest was the proposal to create a Fund for Technical Cooperation (FONTEC) which would:

> "*(a) afford a strategic focus to the Bank's technical-cooperation activities within a multiyear framework; (b) provide a convenient and transparent mechanism through which interested donors might wish to funnel all or part of their technical-assistance resources to the Region; and (c) improve the Bank's internal*

procedures to achieve efficiency gains in the processing and administration of technical- cooperation operations.

4.98 In order to develop a "strategic focus" FONTEC was to:

> *…play a valuable role in the context of the country programming process. Its operations would be programmed on the basis of priority areas and specific objectives and goals of the Eighth Replenishment lending program."*

4.99 FONTEC was never successfully established, in part because of problems with pooling donor funds, but in part because the "strategic focus" it imagined ran counter to the practice of using non-reimbursable resources on a myriad of small, one-off grants. While this practice has been shown to be problematic by previous evaluations, there is nonetheless a powerful "political economy" governing technical cooperation activities, with numerous groups and institutions that benefit from the current pattern. Implementing the new policy will require engagement with the same political economy, hopefully with different results.

4.100 Interestingly, one of the changes proposed by Management in the new policy may actually act to reinforce the existing political economy. The old TC policy prohibited the Bank from executing technical cooperation activities itself, while the new policy allows such action for the development of non-financial products. Given current issues with the budget and resource allocation within the new "matrix," this change has the potential of increasing the (already numerous) claimants for scarce TC resources, to the detriment of more "strategic" uses of TC funding.

4.101 A second area of concern related to the new policy is its lack of specificity on which strategic objectives it intends to pursue. The evaluation findings mentioned above point to the importance of long-term relationships for the effective building of technical capacity in the borrowing member countries. The new policy is silent on this subject, and because of its emphasis on "flexibility," significantly expands the list of potential clients for TC, noting:

> *Legally established entities may receive and administer TC and advisory resources. These executing agencies are: (i) borrowing member countries, including national and sub-national institutions with legal capacity to enter into agreements with the Bank; (ii) regional and sub-regional agencies established by the same countries; (iii) private companies eligible to receive loans from the Bank; and (iv) not-for-profit institutions, including civil society associations.*

4.102 A third issue largely unresolved in the new policy is the relationship between technical cooperation activities and the Bank's business model. The Realignment has put the Bank on a path toward expanding and improving the mix of products and services offered to its clients. Ideally, TC activities should be integrated with that mix of products, along with mechanisms to ensure that all products are delivering real value to clients. For this objective, the focus of TC needs to be on its value added, not its cost. The traditional model of marrying the label "technical cooperation" to non-reimbursable resources has blurred this distinction. With "free money", everything looks like value added.

4.103 A more integrated approach would give member countries a clearer picture of the value and the cost of technical cooperation activities, through mechanisms such as fee-for-service, cost-sharing or contingent-recovery arrangements. Potentially, this would expand both the value of the services to the clients and the prioritization at the country level of scarce resources. The concept of *customers* of those services and their willingness to pay –in some real or at least in some market-simulated currency– would introduce a sort of discipline and counterbalance that the current TC model inherently lacks. Finally this customer orientation would break the current paradigm in which projects are tailored to fit particular funding sources, instead of being driven by client needs and transparently being funded as needed from one or many sources.

D. Recommendations

4.104 There is an agreement across the Bank that knowledge is a critical input to the development process. Theoretically, the Bank could make a major contribution in this area, but a review of past performance shows major problems with the way knowledge-seeking is programmed, the way analytical work is supervised, the way knowledge is disseminated and used by both the Bank's own programs and those of borrowing member countries.

4.105 These shortcomings create an atmosphere of discussion within the Bank that devalues evidence. Issues tend to be discussed without citation to evidence from either the Bank's own analytical work, or the analytical work of others. This makes it more difficult for the Bank to focus on results and performance.

4.106 OVE has made a number of recommendations regarding knowledge production generally and the use of technical cooperation resources in particular. These are discussed above and in the specific studies referred to in these sections. Those recommendations constitute a substantial unfinished agenda in this area.

4.107 Beyond these specifics, there are three general recommendations that grow out of OVE's evaluation work in the knowledge area:

- **First,** The Bank needs to improve the connection between country development problems and the Bank's analytical work. This is not a simple matter of "demand driven" versus "supply driven" approaches. The Bank has limited capacity across sectors to "supply" analytic work, and countries have differing (and changing) areas of "demand" for knowledge. The critical task is to identify optimal matches between supply and demand, so that the Bank works in areas where it has the capacity to make a contribution and the countries have an ability to absorb productively the knowledge produced. This in turn requires the systematic tracking of the utilization and citation of Bank analytical work.

- **Second,** Analytical work is not a commodity; it is a relationship, a relationship built around solving development problems. Problems evolve over time, and today's optimal solution is tomorrow's outdated dogma. The Bank should seek long-term engagement with country problems, and use analytical work to propose new approaches and evaluate the results of these experiments. This will improve both the quality of the Bank's own work and the use of evidence in country decision-making.

- **Third,** Analytical work in pursuit of problem solving is not a Bank-centered process: it is both country-centered and problem-centered. As such, the Bank needs to define its role in relationship to, and ideally, in partnership with, other development actors. Clearly, the country authorities need to be closely involved in this partnership, but it can also extend to a variety of other actors. It is in this context that the financial resources provided by technical cooperation funding can play a catalytic role. The Bank's task is not to produce all the relevant knowledge, but to identify where knowledge gaps exist and help close them through its own work and through the support of other actors working on the same problem.

V. DEVELOPMENT EFFECTIVENESS

5.1 The pursuit of enhanced development effectiveness has been a central objective of the Bank since its foundation. While the term "development effectiveness" has come into wide use only in the past decade, the IDB-8 Agreement called for the "*systematic assessment of the effectiveness of Bank development policies, of the results of Bank-financed activities, and related processes.*[51] Both recent lending framework agreements emphasized the importance of measures to enhance the Bank's development effectiveness. For the most recent NLF, the key recommendation focused on integrating efforts at development effectiveness across a wide range of Bank activities.

> **Recommendation 8**:
> ***Continue Improving the Development Effectiveness of Bank Programs and Projects***
>
> *The Bank should continue to improve its systems to ensure development effectiveness at the corporate, country, and project levels, and provide support to member countries to strengthen their own monitoring and evaluation systems.*

5.2 Before examining these efforts and their integration, some attention needs to be paid to the concept of "development effectiveness" itself. Whenever a phrase comes into common usage, there is a risk that users have different understandings of the underlying meaning of the phrase, resulting in confusion in both discussion and usage.

5.3 In 2002, OVE made the following observations regarding the concept of development effectiveness:

> *While the instruction to focus on "development effectiveness" appears clear, the underlying concepts upon which the instruction is based are in fact quite unclear and do not enjoy a common meaning even within the community of individuals and organizations formally dedicated the pursuit of development.*
>
> *Some insight into these problems of terminology can be found in a recently-completed definitional exercise undertaken by the Working Group on Aid Effectiveness of the OECD Development Assistance Committee. This group produced a Glossary of Aid-Related Evaluation Terms, in which the term "development" is not defined. Instead, the DAC Glossary refers to "development interventions," and defines effectiveness as "the extent to which the development intervention's objectives were achieved." This formulation avoids the critical issue. If development is undefined, then effectiveness means the achievement of whatever goals a project or other intervention sets for itself.*
>
> *Such a definitional structure makes it extremely difficult for any development institution to be held accountable for its actions, since it opens up the possibility of defining trivial objectives whose achievement meets the self-referential test of*

[51] AB-1704, Paragraph 2.100.

"effectiveness," but which fails to accomplish anything meaningful for the countries, which are the target of the intervention.(RE-260, "Development Effectiveness Report").

5.4 Ultimately, then, a meaningful pursuit of "development effectiveness" requires a clear understanding of what specific things the Institution is to become effective at doing.

5.5 RE-260 devoted some time reviewing the literature on development, and came to the conclusion that no universally-accepted definition existed, and that constructing one was very likely impossible. In the absence of such a definition, two fallback positions were identified, one derived from governance, one from economics. The governance position was that "development" was whatever a borrowing member country decided it was. The economic position derived from the fact that the Bank supported development with debt that had to be paid back. In this context, an effective development intervention was one that atleast created sufficient economic value that the country was better off after repaying the debt than it was beforehand.

5.6 Improving development effectiveness at the IDB thus requires improved performance on both the governance and economic dimensions. Improvement along the governance dimension requires increased clarity as to the intended results of Bank activities at both the country and the project level. While borrowing countries were responsible for making the decisions as to what was valuable to them, the Bank was responsible for helping to define these development objectives in clear and measurable terms. To facilitate this discussion, OVE has developed tools for assessing "evaluability" at both the country program and project level. Evaluability does not measure whether an intervention is worth doing; it merely measures how clearly the anticipated results are spelled out.

5.7 Economic analysis is the tool used to determine whether an intervention is worth doing in an economic sense. While some interventions can justify their worth in non-economic terms, economic analysis is nonetheless required to measure the economic costs assumed by pursuing these non-economic objectives. "Development effectiveness" is therefore appropriately assessed by the combination of evaluability and economic return.

5.8 Development effectiveness is not, however, exclusively an issue for the design of interventions. Of greater importance is that the Bank accumulates evidence of the impact its operations are having, and use that evidence in discussion of where to go next. Without evidence of result, discussions of "development effectiveness" can become exercises in empty theorizing.

5.9 Other chapters of this report review elements of this paradigm. Chapter 2 discussed the performance of country programming in generating evaluable statements of expected results. Chapter 4 reviewed the quality of economic analysis in project documents. This chapter will address questions of process, exploring, as Recommendation 8 required, the Bank's progress at establishing:

"*systems to ensure development effectiveness at the corporate, country and project levels.*"

5.10 Before proceeding to the analysis of systems at these three levels, it is important to point out that this NLF recommendation focuses on the Bank undertaking certain kinds of actions that are presumed to enhance development effectiveness. The focus on systems is a focus on processes, not a focus on actual results. Without observing actual results, we cannot empirically establish whether the studied processes actually make the contribution presumed for them.

A. Systems at Country Level

5.11 Since development effectiveness is primarily a concern for the borrower of Bank resources, the NLF recommendation on development effectiveness called for the Bank to:

> *"provide support to member countries to strengthen their own monitoring and evaluation systems."*

5.12 The Bank has been providing support for this objective for a number of years, through components of loans related to public sector modernization and through specific technical cooperation agreements. These efforts were, however, deemed inadequate to address the full scope of the problem, and during the NLF period, a new technical cooperation program called PRODEV was adopted to consolidate and focus efforts on the issue of country systems for monitoring and evaluation. Because of this focalizing decision, PRODEV will be the main focus of this chapter.

5.13 As the principal operational tool for addressing country systems, PRODEV had two fundamental objectives: to integrate all Bank activities related to the strengthening of country systems; and to develop standards for country systems which could lead to certification and thus greater reliance upon such systems by the Bank. In pursuit of these objectives, PRODEV has divided its activities into three separate "subaccounts," linked together in a logical sequence. Sub-account A funds country diagnoses that should lead to action plans for improving MfDR in a country. Sub-account B funds specific improvement projects emerging from the diagnoses, while Sub-account C funds promotions and training activities at the national and regional levels aimed at fostering a culture of MfDR and at providing the kinds of trained human resources needed to implement the new culture.

5.14 To date, Letters of Agreement for the initiation of PRODEV activities have been signed with all borrowing member countries. Twenty countries have approved Subaccount A projects, and seven countries have approved Subaccount B projects. Approximately 80% of the $5 million authorized for complementary support work (Category C) have been committed.

5.15 With regard to its integrating role in country programming, PRODEV has only partially been recognized by the Bank's programming process. OVE's review suggests that about 50% of the CS actually include PRODEV as part of the programming process,[52] but only one treats PRODEV's articulating role in order to support the establishment of results-driven public sector. None refers to PRODEV on the issue of placing greater reliance on country systems.

5.16 In addition, PRODEV projects have rarely harmonized with the programming or the political cycle**.** Although PRODEV's objective is to develop a medium to long term strategy for improving MfDR in participating countries, most PRODEV projects were approved at the end of political cycles and were therefore not integrates into country's programming cycle. Indeed, about half of the projects were approved a year before a change in government and thus were disconnected with the policy dialogue and the programming. As evidence of this problem, OVE's review showed that PRODEV diagnostic work (Subaccount A projects) approved in the last years of a programming cycle have been those with the most difficulty in producing a medium term Action Plan.

5.17 The results of this review suggest that PRODEV has not yet achieved the level of integration into either the Bank's or the countries' programming process which was originally envisioned.

5.18 As noted above, the second major objective of PRODEV was to enhance country capacity to Manage for Development Results (MfDR). While the sequence of PRODEV actions was clearly spelled out in the initial conceptual document, the precise nature of what was meant by country capacity to "Manage for Development Results" was not. The components of an MfDR model were not specified clearly in the initial conceptual document (GN-2346-5), despite the fact that it called for PRODEV to:

> *"assist countries in specific areas of public administration envisioned within the concept of certification, which in turn will progressively allow for increased lending under the new flexible Bank instruments."*

5.19 Certification requires standards against which to certify, and those were absent in PRODEV's initial conceptual documents. The lack of specificity regarding certification was an important issue for the Board of Directors. The Report of the Chairman of the Budget and Financial Policies Committee recommending approval of PRODEV made this observation:

> *"Directors requested that in addition to the reporting envisaged in the original proposal, management should report periodically to the appropriate Committee on progress in defining performance standards for certification and in establishing results-management operations.[53]"*

5.20 In response to these concerns, the PRODEV document proposed to undertake specific actions leading to a capacity to certify. GN-2346-5 proposed that:

> *"...management will provide within a year, the evaluation framework of the impact of PRODEV including the appropriate baselines and performance*

52 For instance, some country strategies, (Jamaica, Uruguay , Costa Rica), indicate that PRODEV would help implement some of the recommendations that emerged from their recent CFAAs and/or CPARs, but they do not specify whether the activities supported by the Program would be coordinated with other Bank projects in the area of development effectiveness.

53 (GN-2346-4).

indicators. As countries work toward certification, these benchmarks would determine eligibility for borrowing within the more flexible instruments the Bank is introducing under the new lending framework."

5.21 PRODEV was launched in June of 2005, but it was not until January of 2008 that Management presented the PRODEV Evaluation System (PES) promised by June of 2006. In the PES document, however, certification is dropped as a central objective of PRODEV. Not only is the term "certification" absent from the document, but the following statement appears:

> *It is worth noting that the PES does not seek to compare the MfDR capacity of the countries in the Region or to establish a ranking among them.*[54]

5.22 Since comparison is the foundation of certification, this decision effectively negates the use of the PES as a building block for the future certification of country systems. In discussions with OVE, PRODEV officials suggest that PES may be upgraded in order to be used for such purposes in the future, but at the present, the system is not being used to pursue this objective.

1) Subaccount A Projects

5.23 The PES document does, however, establish a broad list of elements that need to be included in an effective MfDR country system. Using this document as guidance, OVE has reviewed each of the 20 Subaccount A projects that were intended to produce diagnoses and action plans at the country level. For this review, OVE evaluated each project to determine the extent to which it met the following conditions:

a. ***System-wide or Comprehensive:*** Do the projects include a sufficiently comprehensive diagnosis of the MfDR system to inform choices and prioritization for action plans or future interventions, including: (i) basic components of the MfDR system; and (ii) basic links among components.

b. ***Model-oriented****:* Do the projects propose, a model-oriented intervention logic that includes: (i) identification of fundamental reasons why public policy and public management decisions are currently not based on results; (ii) an analysis of public management shortcomings in terms of their logical implications for MfDR; (iii) an identification of the main causes of public management shortcomings; and (iv) proposals for targeted interventions that are consistent with preliminary diagnosis..

5.24 Against these criteria, OVE has reviewed all Subaccount A projects using a rating scale that ranges between 1 (absent or inadequate) and 4 (adequately defined), OVE has calculated project scores. A score of 1 indicates complete failure to comply with the condition, whereas a score of 4 implies that the condition is met very effectively. Table 5.1 shows the results of this analysis.

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[54] *GN-2346-9 "Managing for development results in the public sector: An analytical tool. PRODEV evaluation system"*, Paragraph 5.30.

Table 5.1
Relevance Assessment Rating Scores

Condition Involved	Assessment Rating Score				
	Absent or inadequate	Partially Inadequate	Partially Adequate	Adequately Defined	Total
a. System-wide or comprehensive					
Include basic components of MfDR system	7	10	3	0	20
Include links between basic components	10	9	1	0	20
b. Model-oriented, MfDR centered					
Why public policy decisions are not result based	11	8	1	0	20
Focuses on implications for MfDR of public mngt. Issues	14	2	4	0	20
Focuses on the causes of public mngt. issues	16	4	0	0	20
Consistent with preliminary diagnosis	1	0	4	15	20

5.25 Table 5.2 shows that, on average, 80% of the projects scored on the bottom values of the scale. The following paragraphs single out some of the main findings of the review.

5.26 Most of the proposed diagnoses are inadequate or partially inadequate because they do not consider all basic components of national systems of MfDR[55] as starting point**.** On the contrary, only 3 projects actually include or propose to undertake diagnoses that cover all the basic MfDR dimensions. The remaining projects are incomplete according to this criterion. In addition, in many cases, the documents address one or more dimensions rather superficially, all of which limits the ability to assess whether the dimensions covered are those that deserve the closest attention.

5.27 Furthermore, most of the diagnoses do not address the links among the various aspects or dimensions of MfDR. In most cases, the different dimensions of the MfDR system are treated as separate, sometime independent, components. Among the projects that address at least some links, OVE found that they do not reflect an appropriate level of depth in the analysis. Out of the 20 projects analyzed, only one project partially addressed the MfDR system as a whole looking at all the links among dimensions.

5.28 The great majority of projects (19/20) do not focus explicitly on MfDR as the center of the proposed diagnosis**.** More than half of projects (11/20) make no reference to the identification of the reasons why public policy and management decisions are not oriented by results. The remaining_projects address the issue marginally. Only one project was considered partially adequate according to this criterion.

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55 As a reference for the basic conditions for the MfDR system, OVE used the pillars included in the *Sistema de Evaluacion del PRODEV* (SEP), mainly Strategic Planning, Result Budgeting, Programs and Projects Management, Financial Management, Monitoring and Evaluation.

5.29 As a consequence of the lack of focus on MfDR, 70% of projects (14/20) fail to specify the logical relationship between the issues they propose to address and the MfDR model.[56] For example, Chile's project document (CH-T1011) proposes to focus on the effects of the Management Improvement Program, also known as PMG, on public agencies' processes and outputs. Yet, the project does not explain why this specific program is as important to the MfDR model in Chile as to become the center of the entire project.

5.30 In addition, none of the projects identify or propose to investigate the main causes of the public management shortcoming they will address. Although many Sub-account A projects suggest examining the strengths and weaknesses of various aspects of the MfDR system, identifying concrete action plans and even implementing specific projects to address different problems, none of them explicitly identifies or proposes to investigate the causes of the problems to be addressed.

5.31 However, the proposed predefined activities as part of the actions plans are internally consistent with the general issues identified in previous or proposed diagnoses. Indeed, the activities proposed by 95% of the projects (19/20) are at least consistent with the preliminary diagnosis included in the projects' documents or proposed diagnosis to be conducted.

5.32 In summary, this evaluation suggests that the Subaccount A project documents provide little assurance on the relevance of the activities they propose to carry out, thus hindering potential use of these diagnoses for further programming and certification activities This is mostly because the diagnoses are often not comprehensive nor oriented by a clear MfDR model. This does not necessarily mean that the actions finally undertaken through the Program may not be, in the end, relevant to general country needs in the area of public administration and management. Yet, its relevance *vis-à-vis* improving countries systems for Management for Development Result is not ensured.

2) Subaccount B: Capacity Development Projects

5.33 PRODEV's logic calls for capacity development projects to be defined as a result of previously defined diagnoses and country Action Plans. So far, PRODEV has approved 7 capacity development projects, yet 4 of them were not preceded by a subaccount A diagnosis or Action Plan. Thus a majority of Subaccount B projects do not conform to PRODEV's design logic.

5.34 Whether or not a Sub-account B project followed from a Sub-account A diagnostic and action plan, it is still possible to evaluate it with reference to the same criteria applied above. A Sub-account B project might, for example, be prioritized in light of a clear model of a country's MfDR capacity despite having no previous Sub-account A diagnosis. Table 5.2 shows the results of OVE's review of the 7 existing Sub-Account B projects.

[56] The few projects that make the MfDR model explicit are Mexico, Brazil and Peru.

Table 5.2

Relevance Assessment Rating Scores

Conditions	**Assessment rating score**				
	1	**2**	**3**	**4**	**Total**
a. Consistency with Diagnoses or Action Plans	1	0	1	1	3*
b. Prioritization	5	2	0	0	7
c. Logic and model-orientation	2	4	1	0	7
Reflects a MfRD intervention model	4	2	1	0	7
Proposes activities that are logically related to a MfDR system	1	5	1	0	7

* Not applicable in the cases of Dominican Republic, Uruguay, Chile and Nicaragua because there were not preceded by a Subaccount A project.

5.35 Four of the projects cannot be assessed for consistency with previous diagnoses or action plans because none were done. Of the three that did have prior diagnostics and action plans, however, two scored relatively well in terms of orienting interventions to the diagnosis.

5.36 None of the B-projects do a good job of explaining the criteria or data used to prioritize certain intervention areas as opposed to others. Despite PRODEV's sequential logic calling for targeting key interventions in a context of limited resources, the projects do not explicitly address the reasons why they select some areas of intervention over others. Indeed, 5 of the 7 projects do not provide any explanation on the urgency, relevance, cost-effectiveness; or critical nature of the proposed interventions in the context of improvements in the MfDR country system.

5.37 Most projects fail to present their intervention model. Indeed, 6 out of the 7 projects propose to finance activities without an adequate explanation of the logical relationship between the proposed interventions and the development of the MfDR system in the country. Only 1 project (Mexico) reveals some definition of the contribution of proposed components to a defined model of MfDR in the country.

3) Subaccount C: Promotion and Training Activities

5.38 There has been a substantial amount of activity financed under Subaccount C, and OVE has not been able to review the documentation on all consultancies, seminars, and training courses funded under this subaccount.

5.39 There is, however, one area on which information is available, and it suggests problems with the complementarity between actions financed under the various subaccounts. This area deals with country assessment of MfDR need. As noted previously, Subaccount A funded diagnostic work in 20 countries as a basis for action plans and Subaccount B interventions. But Subaccount C also funded country diagnostics as part of the process of developing the PRODEV Evaluation System (PES).

5.40 From a management point of view, duplicating diagnostic work is a potential source of program inefficiencies, and this is a concern in itself. Of greater concern, however, is the fact that the diagnostics financed under Subaccount C come to different conclusions with respect to country need than did the diagnostics financed under Subaccount A. This was true for 40% of the countries with diagnostics funded by both Subaccounts.

5.41 In the case of Costa Rica, the PES diagnostic tool indicated that out of the five PES pillars (Strategic planning, results based budgeting, financial management, project management and monitoring and evaluation), the pillar with the lowest score by far is *Result Based Budgeting*. By contrast, the diagnostic produced with subaccount A funding for Costa Rica, stresses two completely different components as the most problematic, namely *Monitoring and Evaluation* and *Project Management*.

5.42 In the case of Chile, although PES considers that all pillars are close to the maximum rating except for *Strategic Planning*, the diagnosis in PRODEV documents focus on *Financial Management* and *Monitoring and Evaluation*, and final funding choices aim at ISO certification as part of other interventions in the area of *Project Management*.

5.43 In the case of Uruguay, where there was no Sub-account A diagnosis, the PES analysis identifies *M&E* as the area needing the most support, but the Sub-account B intervention was designed to support the national investment system (NIS), a component of the *Project Management* category.

5.44 On the basis of this review, the objective of first strengthening, and then relying upon, country systems has not shown much in the way of concrete results during the NLF period. About half of the country strategies approved during the period discussed this as an objective, but primarily with respect to country procurement and financial management systems. Systems designed to track results have not been prominent among the objectives for country programming, and the preliminary results of PRODEV show diagnostic incompleteness and both duplicative and inconsistent approaches to the problem between the three Sub-accounts.

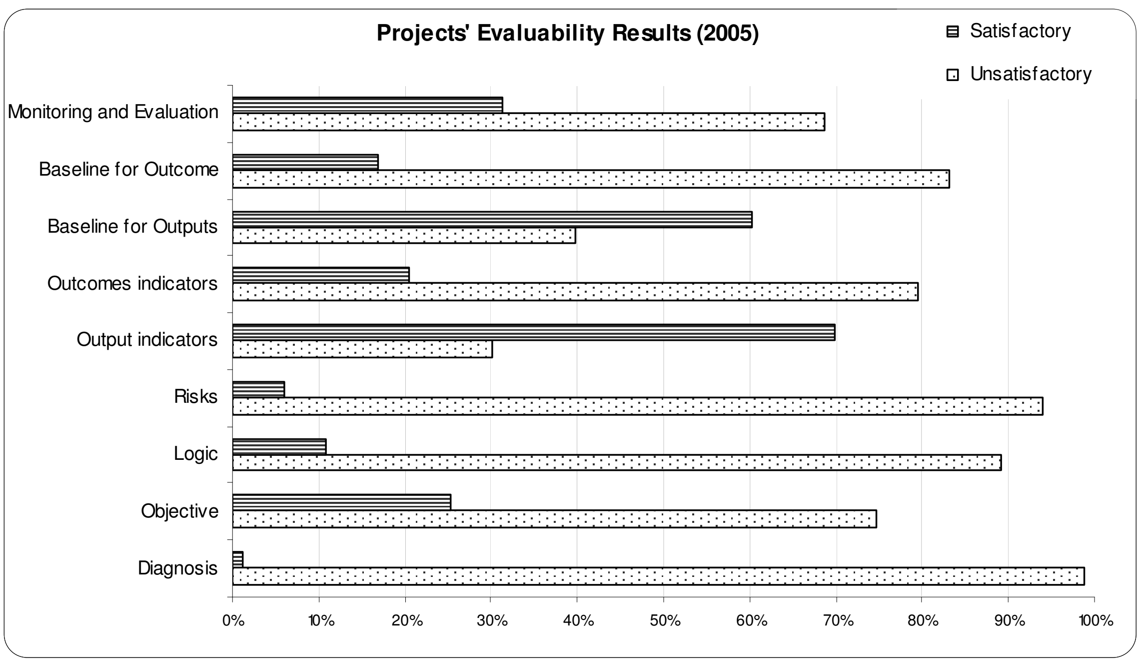
B. Systems at Project Level

5.45 The Bank has a series of processes designed to produce projects for approval by the Board. From a development effectiveness perspective, these systems ought to ensure that projects meet both development effectiveness tests –that they be evaluable and that they demonstrate their economic contribution to the borrowing member countries. OVE's reviews, however, have found poor results on both fronts. More importantly, OVE's recommendations to improve the Bank's systems for producing projects that meet these criteria have generally not been implemented. This section will review briefly the results of past OVE reports on projects (RE-275 and RE-333), and then turn to the issue of the Bank's systems for producing projects.

5.46 OVE developed the evaluability assessment tool in 2000 and applied it to all projects approved by the Board in 2001. That study (RE-275), identified those aspects of evaluability that required improvement and established a baseline value in order to assess progress in project evaluability over time. At that time, Management noted some disagreement with OVE's specific method, but accepted the fact that project evaluability was important and needed to be improved. Subsequently, on a number of occasions since 2001, Management has claimed that the Bank has significantly improved the evaluability of its projects.

5.47 As anticipated in the 2001 report, OVE carried out an assessment of the projects approved by the Board of Directors in 2005 using the same methodology as applied in 2001 in order to allow for a clear measurement of progress from the previously established baseline. The evaluability scores for each project are based on the following nine dimensions: (i) diagnosis; (ii) objectives; (iii) logic; (iv) assumptions and risks; (v) outcome indicators; (vi) outcome indicator baselines; (vii) output indicators; (viii) output indicator baselines; and (ix) monitoring and evaluation. The review of the 2005 projects shows that all of these evaluability dimensions continue to demonstrate considerable deficits in terms of the minimum contents needed for the Bank to manage for results. (See Figure 5.1 below).

Figure 5.1



5.48 A comparison between the 2001 group of projects and the 2005 group showed little overall change over the four year period. Small improvements in indicators were balanced by small deteriorations in performance related to project logic. (See Figure 5.2).

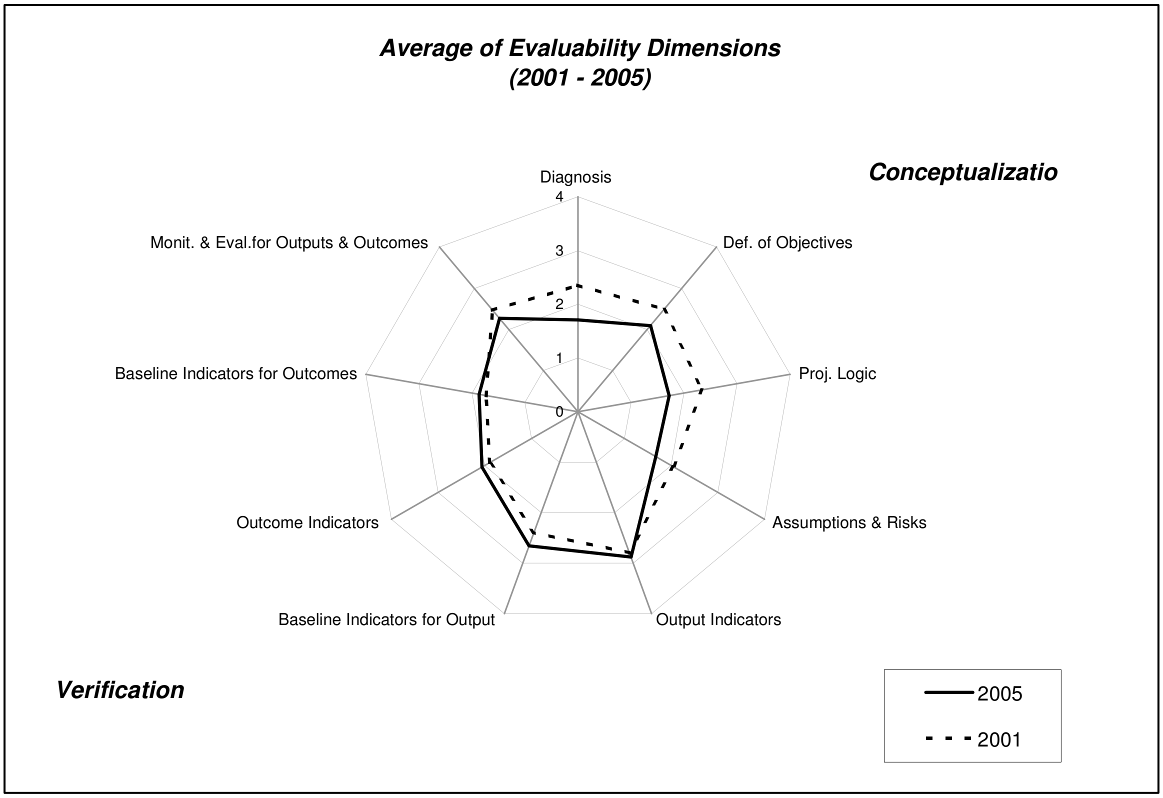


Figure 5.2

5.49 While these findings show significant continuing problems with project design, another OVE oversight review showed that, if anything, the problems were more severe at the level of tracking results of project execution. The Bank's principal tool for tracking results in execution is the Project Completion Report (PCR). Several Bank documents state that the PCR is intended to be a key tool in terms of development effectiveness and managing for development results. Because only 16% of IDB projects eventually receive an ex-post evaluation, the PCR is the only Management-approved final word on the results of the large majority of IDB projects.

5.50 In 2006, OVE reviewed PCRs completed under new guidelines that were supposed to increase the results focus of such reports. (RE-315) The analysis looked at each project's original development objectives and used them to construct a Results Framework (RF) which systematically recorded if each development objective was measured by an indicator that measured outcomes, and if each indicator included a baseline, target, and end data. Then a completeness index was calculated that reflected how much evidence the PCR presents to track the achievement of development objectives. The evaluation found that 18 of the 19 PCRs reviewed did not contain an acceptable Results Framework. The result was that PCRs were claiming "achievement of development results" without any meaningful evidence to support that claim.

5.51 This failure to make progress came <u>after</u> explicit new PCR guidelines had been developed by Management, suggesting ineffective measures to ensure internal compliance with guidelines. The same is true at design level, since the Board provided in 2003 explicit instructions that the Bank should develop and apply a system for rating project evaluability as part of the approval process. This instruction was not followed, and no internal system to screen projects for evaluability was implemented. Management has indicated that such a system will be forthcoming in the proposed "Development Effectiveness Framework," but OVE has concerns that creating such a system will pose a serious challenge to Bank management.

5.52 The reason for this concern is the way in which the Bank approaches the issue of quality control in general. Historically, the Bank has sought to control quality by passing projects through a series of review committees, the most important of which as been the Management Review Committee (CRG). OVE examined the minutes of CRGs to determine the attention paid to evaluability issues during quality reviews of 73 public-sector projects. The results are shown in Table 5.3 below.

Table 5.3
CRG Reviews and Evaluability Dimensions

Dimensions of evaluability	Not considered by the CRG (NC)	
	Total not considered (%)	%NC with unsatisfactory final evaluability
Diagnosis	93%	92%
Definition of objectives	88%	68%
Logic	93%	85%
Assumptions and risks	78%	74%
Output indicators	75%	22%
Outcome indicators	60%	51%
Output baseline	95%	41%
Outcome baseline	88%	73%
Monitoring and evaluation	71%	42%

Source: Elaborated by OVE on the basis of CRG minutes for 73 public sector portfolio projects

5.53 It would appear from these results that the CRGs do not pay significant attention to evaluability issues in the review of projects. This is not a trivial finding, nor is it confined to esoteric matters of evaluation technique.

5.54 OVE's review found that 93% of CRG reviews did not raise questions concerning a project's diagnosis of the problem, nor the logic of the intervention designed to address that problem. 88% of reviews did not address the stated objectives of the project, and 78% did not address issues of assumptions and risks.

5.55 These findings suggest a general problem with quality control of projects, not some specific failure to measure evaluabililty. This impression is confirmed by past experiments to review quality of projects independent of the CRG process.

5.56 In October 2002 the Executive Vice President (EVP) presented to the Board's Policy and Evaluation Committee Management's approach to development effectiveness at the Bank and agreed to conduct an illustrative review of project quality-at-entry. A report on that review was presented to the Board in 2003. (GN-2262).

5.57 OVE pointed out at the time that this review failed to capture the most critical dimensions of project quality, particularly with respect to the problem diagnosis and the adequacy of economic analysis. (GN-2262-1). Despite these limitations, OVE recommended that such reviews be undertaken on a regular basis by Management, so as to improve the methodology. Despite this recommendation, no subsequent Quality at Entry reviews have been performed.

5.58 It is OVE's observation that the Bank has considerable institutional antipathy to quality control of the development effectiveness of projects. Neither the routine CRGs, nor the exceptional Quality at Entry exercises have established a reliable and routine measure for ensuring project quality. Set against this background, the recent changes to the Bank's "project cycle" may work to exacerbate the problem further.

5.59 The Bank's Realignment document identified the problem of quality control in the following terms:

> *The analysis of current practices has identified a pervasive confusion between the roles of quality control and quality enhancement as a key problem in the Bank's present structure and procedures. This confusion means that units nominally charged with quality control and safeguard functions routinely participate in the decision-making process of project preparation that is nominally the responsibility of operational units.*
>
> *This "cohabitation" of quality control and operational support responsibilities generates a cascade of undesirable consequences: accountability of the operational units for project quality is diluted since operations always have the implicit no objection of the safeguard units; the <u>independence of the quality control units is compromised</u> by their subordination to the pressures of project approval and disbursement; the process of reaching a consensus between operational and safeguard units is very time consuming and focuses on changing document texts rather than on risk management in the field.*[57]*(Emphasis added)*

5.60 In response to this analysis, Management has recently made major changes to the way projects are reviewed. The "New Project Cycle," places responsibility for project quality on the project team, and creates a Quality and Risk Review defined in the following fashion:

> *A sharply focused process (the Quality and Risk Review,) to gather Bank-wide comments on project proposals, and to consider all potential issues, will be central to the procedure for enhancing the quality of the proposals. The Sector Division Chiefs, who are responsible for managing the Review, will partner the corresponding Representative, in deciding how best to respond to the issues raised by the Review.* CS-3734

[57] GA-232

5.61 While the New Project Cycle does assign formal review responsibilities to the Environmental Safeguards Group, there is no mention in these documents as to how non-environmental elements of quality are to be assessed, neither by whom, nor against what standard. In effect, the problem identified in the Realignment document that the old procedures compromised "*the independence of the quality control units,"* has been replaced with the new problem that there are no independent quality control units for the development effectiveness of projects.

5.62 Management has indicated its intention to propose evaluability standards for projects in the forthcoming "Development Effectiveness Framework." In light of the concerns noted above, OVE believes it is important that those standards not be proposed in isolation, but be accompanied by a clearly specified institutional process by which projects are required to demonstrate their compliance with these standards.

C. Development Effectiveness of PBL Operations

5.63 In addition to the more general focus on systems for development effectiveness, NLF Recommendation 8 also made specific recommendations with regard to policy-based lending operations as follows:

> *The Bank should prepare guidelines for PBLs, consolidating the existing policies and practices into one document and taking into account the results from the 2004 quality-at-entry exercise and from previous evaluations, as well as the policies and practices of other international financial institutions in this area.*

5.64 Recommendation 8 went on to describe at some length the content that should be included in these guidelines, but the key reference to the development effectiveness came in sub-paragraph (b):

> *Criteria for the utilization of PBLs, taking into account the economic and social gains expected from the program versus its economic and social costs, the linkage to the country strategy, the government commitment to carry out and sustain the program, the financial implications and the capacity to structure and supervise the operation, identifying the risks involved and the relevant fiduciary capacity*.

5.65 The development effectiveness of PBL operations has been a concern in the Bank for several years. One of the three key objectives of the first Lending Framework was for Management to take: "*measures to enhance the development effectiveness of each lending category, particularly Policy-Based and Emergency Lending*" (AG-1/02, Paragraph 2 in the Annex).

5.66 In implementing the 2005-2008 NLF, Management immediately complied with the instruction to set forth Guidelines, issuing CS-3633: ***Policy-Based Loans: Guidelines for Preparation and Implementation*** in April of 2005.[58] The Guidelines require a clear statement of the development objectives and expected results: *The Project Document must clearly state the objective and expected*

[58] No update has been produced after that date. In terms of additional material available, SPD only has a PPT for training COFs available in their webpage.

results (outputs, intermediate outcomes and final impact) of the policy reform and/or institutional change program. The program design must include measurable indicators for monitoring progress during implementation and evaluating the effects of the operation on completion, including baseline data and clear targets.

5.67 OVE has reviewed PBL operations prepared under the new Guidelines. This review finds that there is enormous variance in how well the principles set forth by the Guidelines in terms of indicators and their link to objectives have been followed by Bank projects: there is heterogeneity with respect to the clarity of the objectives, the existence of baselines and the appropriateness of indicators. All projects include a results matrix, most of them as a separate matrix and only four of them embedded in the program matrix. However, where a separate result matrix exists, indicators are usually presented disconnected from the objectives of the project, which complicates the assessment of their appropriateness.

5.68 As stated in the Guidelines, the results matrix should have indicators that serve to monitor progress towards meeting the program's objectives, so it ought to be possible to discern from the matrix how the indicators show progress in meeting the objective. However, perhaps due to the lack of templates or guidelines for results matrices, in some cases the results matrix only includes indicators without providing a link to the objectives.[59] This is further complicated by the lack of a proper identification of project's goal and purposes in the results matrices of PBLs. This is the case in several projects that have a complete set of meaningful indicators, however in the results matrix it is impossible to link them to objectives, as only the titles of the components are present (DR0150, ES0140, NI0183).[60]

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[59] Other limitations that may be related to the lack of a template and guidelines include the confusion between indicator and target, activities and outcome indicators, and indicators with objectives. For example, in the AR-L1009 results matrix, among the "*outcomes*" of the project are included many outputs/activities such as "Incorporación a la Ley de Presupuesto 2007 y siguientes y en el Presupuesto Plurianual de las previsiones presupuestarias para la recompra de deuda.", or "Desarrollo del 100% del modelo conceptual del SIDIF Internet Integral, y del modelo del Módulo de Presupuesto". The HO-0223 result matrix includes as one of the "*medium term outcome indicators*" one of the project´s outcomes: "El impacto de este nuevo modo de gestión se logrará en el largo plazo y, en la medida que se vaya instrumentando en los organismos se podrá lograr, incrementos sustanciales de sus niveles de eficacia y eficiencia en su gestión y en el cumplimiento de las políticas de desarrollo a ellos asignadas. En un plazo de 5 años las instituciones del área social y de infraestructura deberían llevar a cabo sus actividades bajo el nuevo modo de administración."

[60] The guidelines state, "the Project Document should present the basis for the assumptions utilized to link the policy reform/institutional changes (outputs) to the expected outcomes and impact." (3.13). This is an area that needs to be improved; insofar as in many cases there is a lack of logical connection between the objectives and the proposed activities.

Table 5.4
Connections between Objectives and Indicators

DR0150

Area	Indicador
I. Asistencia Social y Protección de Gasto	
A. Racionalización de programas de asistencia social	
Incremento del gasto social ejecutado en % del Producto Interno Bruto (PIB) Reducción del gasto en asistencia social en % del PIB Fortalecimiento de la gestión del Programa de Alimentación Escolar (PAE)	Gasto social en % del PIB. Gasto en asistencia social en % del PIB. Cociente entre número de raciones recibidas y número de raciones consumidas en las escuelas. Porcentaje de escuelas que reciben supervisión al menos quincenal del PAE.

ES0140

Principales ODM 2015	Indicadores intermedios
Protección social	
Reducción de la población bajo la línea de extrema pobreza a la mitad (%). Educación	Tasa de prevalencia de desnutrición (peso/edad) en niños menores de cinco años (%).
100% de matrícula neta en la enseñanza primaria (7 a 12 años) (%). 100% alfabetización de las personas de edades comprendidas entre los 15 y los 24 años (%).	Tasa de sobreedad en tercer grado de educación básica (%). Número de alumnos de siete años matriculados en primer grado de educación básica. Tasa de repitencia en primer grado de educación básica (%).

NI0183

Principales Metas de la ERCERP 2015	Indicadores Intermedios
Educación	
Acceso del 100% en educación primaria (Tasa Neta de Escolarización Primaria).	Número de niños y niñas de seis años matriculados en primer grado. Tasa neta de escolarización primaria (%). Deserción en 1er grado (%). Profesores de primer grado no titulados (%).

5.69 In the case of DR0150, for example, it is not clear how "social expenditures as % of GDP" would show progress of "rationalization of social assistance programs" because it is not specified what the "rationalization" objective means. Not even the sign of the expected change is clear: social expenditures could plausibly decrease or increase to demonstrate "rationalization." Similarly, the precise meaning of "Asistencia Social y Protección del Gasto," is not clear, nor are the links to the indicators obvious.

5.70 In the case of ES0140 and NI0183, indicators are used to track other indicators (the share of population under extreme poverty is an indicator, and undernourishment in children under five is also an indicator –ES0140; access to primary education is an indicator, and so are the net enrollment and the drop out rate –NI0183), and the matrix only includes the title of the components.

5.71 There are several operations that provide meaningful outcome indicators, such as the programmatic series to improve the quality and management of public expenditures in Peru, and the sector program on public financial management in Argentina (AR-L1009). However, some documents presented a brief narrative of "the problem" as a baseline, with similarly unclear targets and indicators (see Table 5.5). In several cases the outcome indicators provided may be meaningful as such (i.e. the poverty rate or other MDG goals in several social sector operations), but the logical connection between the indicator and the activities is not clear.

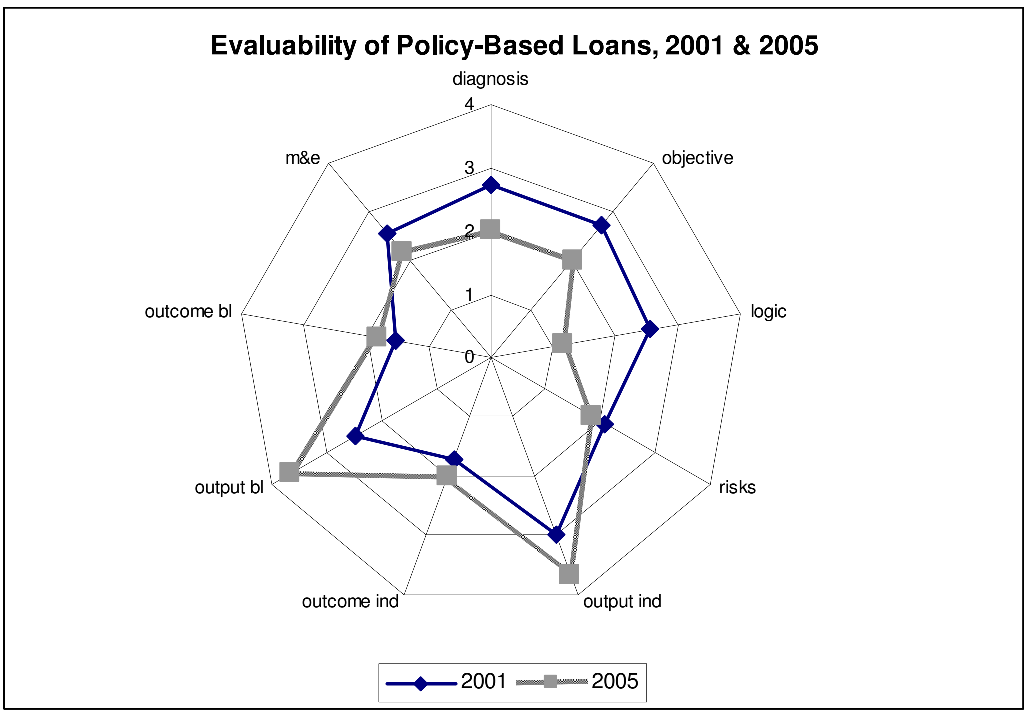
Table 5.5

ADEQUATE AND INADEQUATE INDICATORS: SOME EXAMPLES					
Project	**Objective**	**Indicator**	**Baseline**	**Target**	**Adequate**
UR-L1021	Lograr un sistema impositivo mas equitativo y eficiente	Dispersión entre la participación de los tributos en el total de la recaudación	herfindahl index 0.2354	herfindahl index 0.255	Yes
		Numero de tributos	Numero de tributos 30	15	Yes
		Proporción de tributos indirectos en la recaudación total	Proporción de tributos indirectos en la recaudación total 72%	69%	Yes
PN0160	Fiscal Stabilization	Greater macroeconomic stability with lower fiscal deficit	3.6% preliminary NFPS	average NFPS deficit <1.1%	Yes
		Lower financial and actuarial deficits of CSS	29.7% preliminary deficit	average actuarial deficit <30.8%	Yes
		net Public debt (excluding ACP)	62.9% preliminary	57% of GDP	Yes
HO0223	Ingresos, Administración tributaria y Aduanera: Reconstruir el marco institucional de la Dirección Ejecutiva de Ingresos (DEI) para iniciar un nuevo proceso de desarrollo sostenible de la entidad, comenzando por su estructura orgánica.	Ante el crecimiento sostenido del intercambio comercial, regional y extra regional, y en las perspectivas de integración a los mismos la transparencia, eficacia y eficiencia de la administración aduanera son determinantes en los ritmos y orientaciones de los procesos de desarrollo económico y social. Este impacto positivo sobre el desarrollo se puede seguir compartiendo los indicadores ya señalados para la nueva institucionalidad DEI en materia de integridad institucional y reducción del contrabando.			No
		Aumento de la equidad del sistema tributario por reducción de la mora, la evasión y la elusión de los grandes y medianos contribuyentes. Se completa la depuración del E-TAX para todos los contribuyentes			No
		Aumento en la seguridad jurídica que se deriva de un único y moderno marco legal para regular las operaciones aduaneras así como una administración aduanera dotada de una herramienta informática de gestión que refleje un procedimiento aduanero de forma de facilitar y controlar adecuadamente el comercio internacional, sin descuidar la protección del interés fiscal.			No
		Disminución sensible en el monto de la deuda tributaria registrada y cuya cobranza no está siendo gestionada judicialmente y aumento de la percepción de riesgo por parte de los contribuyentes. Implantación del módulo de fiscalización del E-TAX.		100% de saldos históricos depurados y 100% de las declaraciones y pagos se procesan casi en tiempo real para grandes y medianos contribuyentes	No
		Grado de cumplimiento voluntario de las obligaciones tributarias		80% mínimo	Yes
		Niveles de evasión	Baseline: 40%		Yes
		Personal de la DEI gestionando la administración tributaria y aduanera bajo claras funciones y responsabilidades y procedimientos transparentes en la relación con los contribuyentes y usuarios del servicio aduanero; todo lo que debe redundar en un mejoramiento de la imagen sobre la integridad institucional.			No

5.72 Having indicators in the initial proposal is only one part of the problem. As loans implement, results actually achieved need to be tracked as well. OVE calculated a completeness index for the policy-based loans approved between 2005 and 2007. This exercise determines how many of a project's sated objectives have adequate indicators, baselines and targets, along with sufficient evidence that their achievement (or non-achievement) could be verified. A "complete" project has a score of 1.00, indicating that all objectives can be verified. This analysis shows that approximately half of the stated objectives in PBL operations can be verified. There is basically no difference between PBLs and PBPs (0.58 and 0.54, but the difference is not statistically significant), and there is also no clear trend over time. Also, this index shows the share of objectives that have indicators, baselines, milestones and targets, but not whether or not the indicators are adequate. When this is taken into account (basically only counting those indicators that have an adequate metric for the objective), the index goes down to 0.41 and 0.44 for PBLs and PBPs.

5.73 In this context, it is interesting to contrast the results from OVE's evaluability exercises conducted in 2001 and in 2005. As the next figure shows, while overall there was no progress on the dimensions analyzed by OVE, there was an improvement in terms of the use of output and outcome indicators, as well as in the existence of baselines. These results are consistent with the analysis done so far, in the sense that projects do incorporate results matrixes where indicators with baselines and targets are required. Also, they should pose an alert in the sense that projects have not improved in their diagnosis, definition of objectives, logic, and risk analysis.

Figure 5.3



5.74 The first objective of the NLF section dealing with PBLs was that such operations needed to demonstrate: "*the economic and social gains expected from the program versus its economic and social costs.*" The Guidelines translate this expectation into the two paragraphs of instructions shown in Box 5.1

Box 5.1
Guidelines for Analytic Work

3.17 *Analytic Work*. A PBL should be based on relevant analytic work on the country and the sector undertaken by the country, the Bank and other development partners. The Project Document should illustrate how the relevant country and sector analyses used in the preparation of the operation underscore the design of the proposed operation. The work should focus on policy issues and options facing the country and the sector; an assessment of the political feasibility of the proposed reforms; and, when applicable and feasible, include ex-ante simulations of the implementation of the proposed reforms. The choice of tools and the depth of the analysis will depend on the nature of the reform, the timeframe for the analysis, the information base, and the resources (including country-level capacity) available.

3.20 *Economic Analysis*. When feasible, the Project Team should analyze the economic impact of the proposed policy reforms and/or institutional changes in comparison to the expected cost of the reforms in order to provide "reasonable assurance that the national economic gains of the program outweigh its economic and social costs."18 However, the Bank recognizes that for many of the reforms and institutional changes supported by PBLs, the available information may facilitate only qualitative economic analysis.

Source: CS-3633 Policy-Based Loans: Guidelines for preparation and implementation

5.75 Although the guidelines are both vague and general, actual PBL operations generally do not contain analysis that satisfies the Guidelines. OVE recently completed an analysis of the quality of the economic analysis included in the Bank's operations, the results of which are summarized in Chapter 4 of this report. Comparing PBLs and investment loans show that both performed relatively poorly in terms of the quality of economic analysis, however, PBL operations did score better than investment loans in the dimension related to the quality of the treatment of debt-related issues.

5.76 The final evaluative finding relating to improving the development effectiveness of PBL operations relates to the expectations established by the Guidelines. Good practice in other development institutions has placed increasing emphasis on the quality and level of detail that is expected of economic analysis. The IDB remains well behind other institutions in this area, as can be seen clearly in the work done by the Economics and Research Department of the Asian Development Bank in 2003 on the analytical requirements for PBL operations.

Box 5.2
Analytical Expectations for PBL in the Asian Development Bank

• Reliance on qualitative assessments results in non-parametric analysis and does not permit order of magnitude impact assessment projections. The greater the quantitative and parametric analysis, the greater the possibility of identifying the magnitude of outcomes and predictions.

• As a minimum, descriptive statistical analysis is required to provide an order of magnitude assessment of the economic and social situation as a starting point for assessing possible impacts.

• Where qualitative assessments and a priori reasoning are to be relied upon, then the limits of the analysis and the underlying assumptions should be clearly stated.

• The initial descriptive work and the nature of the policy change will provide guidance as to whether there will likely be significant feedback effects that will guide further analyses, especially the sufficiency for partial equilibrium analysis or the need for general equilibrium analysis.

Source: Asian Development Bank, "*Economic Analysis of Policy-Based Operations: Key Dimensions"*
http://www.adb.org/Documents/Books/Eco_Analysis_PBO/default.asp

5.77 A comparison of Box 5.1 and 5.2 show clearly that the analytical expectations for PBL operations is much higher at the Asian Development Bank than at the IDB. An examination of the underlying AsDB documents only increase the disparities between the institutions. In addition to much greater rigor demanded of economic analysis, the AsDB approach also expects PBL operations to analyze in detail the political economy dimensions of proposed reforms. This improves the risk analysis in projects, and helps anticipate execution difficulties.[61]

5.78 OVE believes that enhanced development effectiveness of PBL operations requires much more thorough analysis than is called for under current Bank Guidelines. Accordingly, OVE recommends that the 2005 Guidelines be re-examined in light of good practice in other Institutions.

D. Development Effectiveness of Emergency Lending

5.79 The New Lending Framework recommended that the "*Emergency Loans should continue to be made available to borrowing countries, recognizing the importance of economic stability for development."* As noted earlier, the Bank did not approve any emergency loans during the NLF period, and thus there is no new data upon which to base an evaluation. In the course of preparing the 2002-2005 Lending Framework, however, the Board approved new Guidelines laying out the developmental rationale for Emergency lending that remained in effect throughout the 2005-2008 period:

> *As the Board of Governors has stipulated, the primary objective of Emergency Lending is to provide financial support to help address the effects of international financial crises on the Region's economic and social progress, to*

[61] Asian Development Bank, "Toward a Political-Economy Approach to Policy-Based Lending." Economics and Research Department, Working Paper 14, May 2002. http://www.adb.org/Documents/ERD/Working_Papers/wp014.pdf

mitigate the effects of crisis on the poor and vulnerable, protect funding for social programs that benefit the poor, and avoid reversal of policy reforms.

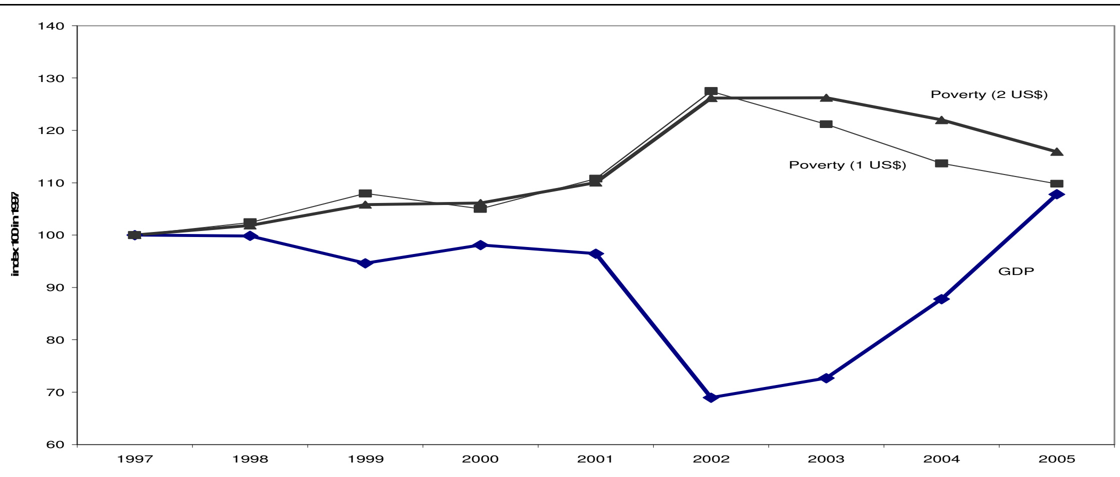
5.80 Half of these stated objectives relate to protecting the poor from macroeconomic volatility, through enhancing social program expenditures in times of crises. These developmental objectives were married to a lending instrument with economic terms and conditions that were much less favorable than those available on standard Bank loans. These terms, combined with the absence of "international financial crises" during the NLF period, meant no new emergency lending during the period under review.

5.81 Given the historic record of volatility in the Region, however, it is prudent to assume that the present benign economic climate will last forever. When the next crisis comes, the Bank should be well-prepared to meet it.

5.82 As part of its ongoing work program, however, OVE has been examining the issue of how the Bank helps countries to compensate for the costs of systemic disruptions caused by either dramatic policy change or international financial crises. That work has led OVE to the conclusion that there may be more effective ways of implementing the developmental objectives contained in emergency loans. This section will explore these alternatives.

5.83 The economic arguments for protecting the poor from economic volatility are sound. Figure 5.4 demonstrates several important points about the relationship between poverty and economic crises. Using two definition of poverty ($1 per day and $2 per day) the chart shows that the most recent major downturn in the Region caused about 6.2 million people to fall into poverty ($2/day), and 13.7 million into extreme poverty ($1/day) between 1997 and 2002.

Figure 5.4
LAC: GDP and Poverty



Note: (i) the Chart excludes Haiti, Salvador, Mexico, and Nicaragua who did not have an identifiable poverty cycle; (ii) Argentina, Colombia, Dominican Republic, Guatemala, Honduras, Jamaica, Uruguay, and Venezuela had not reduced poverty levels to the levels of 1997 by 2005.

5.84 The chart also shows that while GDP rebounded strongly from 2002 to 2005, poverty responded only weakly to the rebound. By 2005, there were still 4.1 million more poor, and 12.1 more extreme poor than in 1997. The negative effects of downturns on the poor are thus not compensated for by equivalent positive effects in the next upturn.

5.85 Detailed empirical work on household response to downturns also confirms that the effects are potentially very long lasting. Poor households respond to crises by taking children out of school so that they can help support the family, thus harming the children's long term earnings potential. Similarly, studies have shown that the dietary quality of poor households also deteriorates in a crisis, behavior with particularly negative long term effects on younger children.

5.86 In light of these developmental objectives, OVE examined each emergency lending operation, together with a number of "ordinary" PBL operations with poverty-related objectives, to see how effectively these projects "protected" the poor from the effects of economic volatility. All projects identified particular social expenditure programs to be "protected," and all provided data on completion that expenditures had been maintained at the anticipated levels.

5.87 However, because these were policy-based operations, none of the projects tracked social expenditures in sufficient detail to establish convincingly that the poor had been "protected". Confirmation of protection would require a data series on protected program expenditures a few years in advance of the crisis, during the crisis, and a few years after the crisis. This kind of data is not provided in the project completion reports of <u>any</u> of the emergency or poverty-related PBL lending operations. It is thus not possible to know whether the nominal social protection expenditures reported upon project completion represented a real stabilization over the historic base during the crisis period.

5.88 A second issue relates to the design of these operations, which attempt to establish a "floor" under certain key social expenditure programs. While such a floor may protect spending from falling further, what the economic analysis suggests is that social protection spending should increase, not merely stop falling, during crisis situations. As the crisis throws more households into poverty, a sensible social protection program would provide more resources to support the greater number of poor. This cannot be shown as a verifiable result in the Bank's PBL/EME lending operations.

5.89 As discussed in Chapter 3 of this evaluation, however, the Bank does have instruments that track expenditures directly. Increased use has been made of investment lending instruments since the adjustments described in Chapter 3, and of particular interest are the expenditure-based loans which disburse on a "wholesale" basis and thus avoid the delays associated with procurement. Many of these wholesale loans support transfer programs targeted specifically on the poor. It might therefore be possible to meet the social protection objectives built into emergency loans with a minor re-engineering of the design of "wholesale" investment loans.

5.90 Table 5.6 conducts a "what if" analysis of the last major cyclical downturn (1998-2002) to determine if IDB resources mobilized under emergency and PBL operations would have been sufficient to protect the poor in those countries where there is an identifiable poverty cycle associated with the GDP cycle. The exercise assumes that IDB disbursements from these instruments were used to fund social expenditure programs perfectly-targeted to the poor. The analysis shows that only 24% of actual disbursements made using PBL and Emergency instruments would have been required to keep poverty from rising during the crisis, assuming a perfect targeting of expenditures on the poor. Using either the $1 dollar per day or the $2 dollar per day standard for poverty, the Bank disbursed between $12.9 and $5.5 billion more than would have been required to protect the poor (identified as "surplus disbursements" in the table.)

Table 5.6

Crisis, Amount Needed to Prevent Poverty from Rising and IADB's Disbursements

		Poverty Cycle		Amount in millions needed to prevent poverty from rising		IADB Disbursements. PBLs, PBP and EME		Surplus disbursements:Disbursed / Amount needed (%)		Surplus disbursementsDisbursed - Amount needed million US$	
	GDP Cycle	1 USD Pov.	2USD Pov.	1 USD Pov.	2USD Pov.	Disbursemen	Period	1 USD Pov	2USD Pov.	1 USD Pov.	2USD Pov.
Argentina	1998-2005	1998 - to date	1999- to date	$ 554.7	$ 3,111.3	$ 5,930.0	1998-2005	10.7	1.9	5,375.34	2,818.74
Bolivia	.	1997-2004	1997-2005	$ 293.2	$ 610.3	$ 302.4	1997-2005	1.0	0.5	9.27	(307.87)
Brazil	.	1998-2002	1998-2002	$ 293.7	$ 904.0	$ 3,896.4	1998-2002	13.3	4.3	3,602.69	2,992.42
Chile	1998-2000	1999-2001	no	$ 0.5	$ -	$ -	1998-2000	-		(0.50)	-
Colombia	1998-2001	1999 to date	1999 to date	$ 707.8	$ 1,775.7	$ 3,661.0	1999-2005	5.2	2.1	2,953.18	1,885.34
Costa Rica	.	1997-2005	1997-2004	$ 14.8	$ 26.1	$ 55.8	1998-2002	3.8	2.1	41.01	29.67
Dominican Republic	2002-2004	2002 - to date	2002 - to date	$ 33.2	$ 209.7	$ 389.1	2002-2005	11.7	1.9	355.91	179.43
Ecuador	1998-2001	1994-2001	1994-2001	$ 113.0	$ 138.5	$ 352.3	1994-2000	3.1	2.5	239.34	213.80
Guatemala	.	2000 to date	2000 to date	$ 189.9	$ 358.3	$ 199.8	2000-2005	1.1	0.6	9.86	(158.45)
Honduras	1998-2000	1999 to date	1999 to date	$ 113.2	$ 270.4	$ 118.5	1999-2005	1.0	0.4	5.27	(151.91)
Jamaica	1996-2001	1999 to date	1999 to date	$ 601.9	$ 947.0	$ 217.8	1999-2005	0.4	0.2	(384.12)	(729.21)
Panama	.	1997-2002	1998-2002	$ 10.3	$ 15.7	$ 127.0	1997-2002	12.3	8.1	116.67	111.25
Paraguay	1998-2003	2001-2003	2001-2004	$ 13.0	$ 67.3	$ 39.7	2001-2004	3.1	0.6	26.71	(27.63)
Peru	1997-1999	1997-2000	1997-2000	$ 49.0	$ 269.0	$ 746.5	1997-2000	15.2	2.8	697.51	477.52
Uruguay	1998-2005	2001 - to date	2001 - to date	$ 2.4	$ 37.3	$ 985.0	2001-2005	418.6	26.4	982.65	947.74
Venezuela, RB	2001-2005	2001 - to date	2001 - to date	$ 1,173.8	$ 2,811.2	$ -	2001-2005	-	-	(1,173.79)	(2,811.19)

Note: (i) the table excludes Haiti, Salvador, Mexico, and Nicaragua who did not have an identifiable poverty cycle; GDP and poverty cycle dates are identifiable if there are peak-trough recovery points and where peak to recovery is more than two years; surplus is determined by calculating the Foster-Greer-Thorbeck income gap and taking that quantity from the IADB's actual disbursements.

5.91 The preceding exercise is only hypothetical. Perfect targeting of social programs is not a current reality in any of the Bank's member countries, and it is unrealistic to believe that disbursements could be translated into increased incomes for the poor without considerable frictional losses.

5.92 The exercise does, however, demonstrate that the development goals set for existing emergency PBL operations could also be pursued using other instruments. In fact, a number of the current cash-transfer programs supported by the Bank through expenditure-based loans might actually be better suited to this task. By working with such programs during non-crisis periods, the Bank could help countries improve the targeting efficiency of social spending, and set up mechanisms for increasing disbursements rapidly in times of crisis. Such an approach would ensure that spending on the poor actually increased during the crisis, as opposed to the more ambiguous objective of "protecting" such expenditures in past emergency operations.

5.93 In light of this finding, OVE would recommend that the Board and Management study the possibility of devising mechanisms for promoting stability during a crisis by rapidly ramping-up disbursements through instruments that track expenditures on the poor directly, rather than confining that objective to emergency lending operations.

E. Systems at the Corporate Level

5.94 This section of the evaluation will review the actual activities undertaken at the corporate level since the approval of the NLF. As this section was being finalized, however, Management produced a new Development Effectiveness Framework that addresses a number of issues related to Management's new approach to development effectiveness. OVE will offer comments on the new DEF when the document is presented to the Board for consideration, but this issue will not be covered in this chapter. There are two reasons for this: First, Management's new document is not finalized at the time of writing this evaluation report, and thus evaluative comment would be premature. Second, it describes actions that Management proposes to take in the future, not actions already undertaken. If the Board approves Management's approach, OVE will be in a position to evaluate achievements in this area in the future, but has no evidence regarding results of this initiative at this point.

5.95 In reviewing actions actually taken to "consolidate a results-focused corporate system," OVE would point to three specific areas: the results focus in the Realignment; results-based budgeting; and the results orientation of the Corporate Performance Framework.

5.96 **Realignment.** According to the initial Realignment document (GA-232), an increased focus on results was one of the two "basic objectives" of the Realignment:

> *i) To increase the development effectiveness of Bank activities by means of a greater country focus, deeper sector expertise and improved management based on risk management and attainment of results. This is how the Bank will enhance its relevance in the Region.*

5.97 At the same time, the Realignment document itself did not define a clear results-framework for its own activities. In only a few areas, principally those related to the time required for loan processing and approval did the Realignment document define the nature of the Bank's problems in measurable terms, and even in those areas, the target level for improvement in these indicators was not clearly specified.

5.98 As part of the process of approving the Realignment, the Board requested OVE's views on an appropriate results framework for this activity. In response, OVE prepared RE-329 that proposed 21 indicators to measure the results of the Realignment.

5.99 The core concept of RE-329 was that the Board should be able to hold Management accountable for delivering improved institutional performance measured against an agreed-upon set of performance indicators. This provides advantages for both Management and the Board. The Board gets a clear set of measures of institutional performance against which "results" can be assessed, and Management gets the freedom to manage the institution in whatever manner it deems necessary in order to deliver results.

5.100 RE-329 argued that the Bank needed indicators of performance in three "mission critical" areas: improving understanding of the situation in borrowing member countries; improving the value-added of Bank operations; and increasing the productivity of the Bank in delivering value to clients.

5.101 **Corporate Performance Framework** Neither the indicators proposed in RE-329 nor any other specific performance indicators were adopted by the Board when it approved the Realignment. In April of 2008, however, Management presented to the Board a proposed "Corporate Performance Framework" which was designed to "*allow shareholders to monitor the Bank's overall performance through clearly articulated goals and measures*."[62]

5.102 Box 1 shows the indicators proposed for the Corporate Performance Framework.

[62] GN-2480, "Corporate Performance Framework," 24 April, 2008, Paragraph 1.

Box 1: The Bank's Corporate Performance Indicators

1. Partner with clients that can have a positive impact on development	
Country Focus	*1. % of country strategies that have satisfactory scores in evaluability dimensions*
	2.% of country strategies that have results that can be validated for: *(i) identified priority areas* *(ii) financial envelope* *(iii) country system capacity building and alignment*
Development Results	*3. % of new operations with satisfactory scores on evaluability dimensions*
	4. % of completed projects with results that can be validated
	5. % of completed projects with demonstrated positive results
	6. % of projects with high environmental and social risks that are rated satisfactory in implementation of mitigation measures
2. Offer relevant products and services to our clients	
Client Satisfaction	*7. Rank of IDB with respect to other development partners in terms of:* *(i) Relevance of ideas and products;* *(ii) Responsiveness to client needs;* *(iii) Effectiveness as an implementation partner*
Market Share	*8. Change of IDB Group's share of:* *(i) Outstanding multilateral debt;* *(ii) Outstanding portfolio of NSG operations* *(iii) Concessional(grants, co-financing, TC Funds) resources delivered to the Region*
3. Use the Bank's Resources Efficiently	
Efficiency	*9.Efficient allocation of the Bank's administrative resources:* *(i)Total Expenses on Client Related Products/Total Expenses* *(ii)Total expenses on Corporate Products/Total Expenses* *(iii)Total expenses on Support Functions/Total Expenses*
	10. Capital Efficiency measures to be defined in the New Operational Framework.
4. Foster an Institutional Culture that lives by its values	
Managerial Excellence	*11. % of supervisors and team leaders that measure favorably in leadership competencies*
Positive Work Environment	*12. % of staff that view that the Bank (engagement survey):* *(i) has an ethical work environment;* *(ii) is a meritocracy;* *(iii) has opportunities for career growth;* *(iv) has an environment that promotes collaborative work across organizational units*
Diversity	*13. % of females in management placements (E,R, Grade 1) and in Senior grades (2 and 3)*
	14. % of staff from indigenous and afro-descendant origins

5.103 In commenting on this document to Management, OVE noted that the intent appeared to have been to provide a framework of performance indicators that could be used by the administration to "manage for results" and by the Board as a framework to hold the administration accountable for results achieved. The actual indicators provided, however, did not provide a basis for either objective. Results based management requires the definition and monitoring of those results that are critically important to the institution, while accountability demands clear measurement of progress against stated objectives. The indicators provided in this document fail to track critically important results (like value provided to the Region, tracked by only indicator #5), and instead track issues like institutional culture (4 of 14 indicators), whose contribution to the Bank's mission is less clear. In addition, the indicator set fails to establish an adequate basis of accountability since neither baseline data (the current situation) nor future intent are specified for any of the chosen indicators.

5.104 When the Board considered the Corporate Performance Framework, many of these issues were brought up in discussion, and the Organization, Human Resources and Board Matters Committee did not approve the document. Instead, a decision was taken to combine discussion of the Corporate Performance Framework with the forthcoming Development Effectiveness Framework.

5.105 At approximately the same time that the Corporate Performance Framework was being developed by one unit within Management, another unit approached the same general problem from a very different direction. Following the lead established by the IIC, the unit responsible for the Bank non-sovereign guaranteed lending developed a "Development Effectiveness Matrix" (DEM) for use in both approval and monitoring of these operations.[63]

5.106 The DEM differed from the Corporate Performance Framework by placing emphasis on actual results in the Region. The DEM proposes 29 specific indicators, grouped into 7 areas as shown in Box 5.3. As the box suggests, five of the broad thematic areas, and 20 of the 29 indicators are linked in some fashion to development outcomes in the borrowing member countries. This compares to only 1 out of 14 indicators for the Corporate Performance Framework.

Box 5.3
Development Effectiveness Framework for SCF Projects

1. Project or Company Performance 2. Contribution to Economic Development 3. Environmental and Social Effects 4. Private Sector Development 5. IDB Strategic Development Objectives	Development Outcomes
6. IDB Financial Additionality 7. IDB Non-Financial Additionality	Additionality

[63] GN-2473-1 "Development Effectiveness Framework for SCF Projects," March, 2008

5.107 While there are a number of technical issues with respect to the SCF proposal that warrant closer review, it is OVE's view that the DEM approach provides a stronger and more explicit link to key outcomes such as the economic returns of the project than is provided for in the Corporate Performance Framework. OVE understands that the DEM approach has subsequently been adopted by Management, and will form the basis for implementing the new Development Effectiveness Framework.

5.108 **Results-based Budgeting.** The task of consolidating a results-focused culture depends heavily on the key institutional incentives facing managers within the institution. For most Managers, the principal incentive relates to resource allocation, and thus any meaningful progress on "managing for results" must rest on a reasonable system of "budgeting for results." Such a system is not in place at the Bank, and its absence has been an issue for many years.

5.109 In 1998, a Board Working Group, supported by Management, issued a report on "Budgeting for Results at the IDB." The Working Group surveyed both the Board and Senior Management and arrived at this statement of the problem:

> *First of all, many respondents did not believe that the current budget truly makes Management accountable for delivering Board-mandated results with Board-approved resources. Partly as a result of these doubts, many directors are reluctant to concede greater flexibility to Management in the use of resources, resorting instead to blunt caps on inputs and other forms of micro-management. Neither the directors nor the managers are satisfied with this approach.*[64]

5.110 To address this problem, the Working Group proposed that the Bank's budget be organized around "performance agreements" which were seen as "*contracts drafted during the stage of budget discussion and specify the results the Administration commits to deliver using the agreed-upon resources.*"

5.111 Despite a broad recognition of the problem, and broad agreement with the Working Group's findings, most of the 1998 recommendations were never implemented. Performance indicators were progressively included in budget documents, but usually in a separate section, unconnected to resource allocation. Performance agreements were never devised or implemented. Neither the 2002 nor the 2005 Lending Frameworks made explicit mention of budgeting for results.

5.112 In an attempt to address these longstanding recommendations, Management's 2007 budget submission returned to the theme of budgeting for results, claiming:

> *A set of key performance indicators has been developed to accompany the implementation of the 2007 budget, which will comprise not only quantitative lending and disbursement targets, but also internal efficiency and portfolio performance parameters. These indicators will, in turn, help guide the reallocation of human and budgetary resources throughout 2007 and also will serve, in part, as an entry point for elaborating the triennial, results-based budget for 2008-2010.*

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[64] GN-2021, "Budgeting For Results at the Inter-American Development Bank," July, 1998, Paragraph 3.51.

5.113 As part of its work on managing for results, OVE produced an oversight note on the implementation of these objectives in the 2007 budget. It found that the 2007 budget contained 56 performance indicators, 42 of which were related to either approvals or disbursements, a far too narrow set of institutional priorities. Virtually all of the indicators related to Bank behavior. There were no indicators that track value delivered to shareholders, development effectiveness or the achievement of external targets like the Millennium Development Goals. It is only by linking Bank behavior to these external measures of value that the Bank can understand and improve its impact on the Region.

5.114 Another key problem what that the budget did not assign responsibility for producing results to individual organizational units. In effect, this made the anticipated results the product of the entire Bank, with none of the performance contracting elements contained in the Working Group report.

5.115 In response to OVE's oversight note on "Budgeting for Results at the IDB," the Policy and Evaluation Committee requested OVE's suggestions on what actions should be taken in the short term to improve the Bank's ability in this area. OVE's report (RE-334) made five specific recommendations:

1. Select a reduced set of institutional performance indicators that measure the strategically important core goals.
2. Select performance metrics that include impact of the Bank on the Region as well as information on internal performance.
3. Clearly assign a stream of budgetary resources to the achievement of key performance targets.
4. Clearly assign institutional responsibility for resource use and results delivery.
5. Establish procedures for feeding performance information from 2008 into the preparation process for budgets in 2009 and later.

5.116 These recommendations were endorsed by the Policy and Evaluation Committee at its meeting of November 29, 2007. Recognizing the difficulty of the task laid out, the Board also asked OVE to recommend a gradual approach to this issue. In response, OVE indicated that Board and Management concentrate initially on the first two recommendations, since the entire process of results based budgeting requires a clear initial specification of the results desired. Specifically, OVE recommended the following series of actions:

1. Senior Management should propose to the Board by no later than March 1, a manageable set of institutional performance indicators that will form the basis for results monitoring in the budget process. This indicator set should track both internal performance and external performance, and have a plausible link to resource allocations within the Bank.
2. The Board should review and approve these indicators as the first step in preparation of the 2009 budget.
3. Management should present as part of the "budget issues paper" in mid-2008, baselines for the specific indicators that will be used to measure performance of the Bank as a whole, and each Vice Presidency separately.

These will establish the starting point from which future improvements are to be measured. These baselines, along with the other items in the budget issues paper, will be discussed with the Board.

4. Senior Management should identify in the budget issues paper the key institutional products that deliver value to clients, and identify the internal processes used to produce these products. Estimates of the current costs of these processes should be prepared, as a baseline against which to measure future progress.

5.117 In response to this set of recommendations, Management indicated to the Board that it *"…was preparing to submit a proposed set of priority indicators (Corporate Performance Framework) by yearend to track such key questions as the cost of producing various Bank activities.*[65]*"* As noted above, however, the Corporate Performance Framework when it was eventually presented did not provide any indicators connected to resource utilization. None of OVE's other recommendations have been implemented.

5.118 In June of 2008, however, Management distributed to the Board a document on "Rules for Coordinating Resource Allocation for the Bank's Operational Program (GA-238-6) which begins to take steps in the direction of results-based budgeting. This document applies a new set of procedures to the part of the Bank's administrative budget that supports the operational program. For this part of the budget, Country Department General Managers will prepare "country and regional business plans" which will form the basis for the budget submission to the Board.

5.119 According to the document: "*The Country and Regional Business Plans identify the products and services, including both financial and non-financial products, which will be delivered for a specific country or country grouping and that involve a performance agreement between VPC and either VPS or VPP."* The precise content of these "performance agreements" is not specified, but the document does make clear that they will form the basis for budgetary accountability during execution.

5.120 The document states that country and regional business plans will contain "agreed performance targets (milestones and expected results)" and that Sector and Knowledge Departments will receive budget allocations in tranches from the VPC, with later tranches requiring demonstrated progress in achieving performance objectives.

5.121 This is an interesting new departure in budget practice, but it is too soon for OVE to form an evaluative opinion on the initiative. From a design point of view, the initiative is clearly partial (being applied only to approximately half of the Bank's administrative budget), and not obviously based on the costing of activities (although there is a vague reference to applying "costing parameters" to business plans). Until the actual business plans are prepared and the performance agreements developed, it is not clear whether they will "track both internal and

[65] Minutes of the November 11, 2007 Policy and Evaluation Committee Meeting.

external performance" as OVE had recommended. And until decisions are made with regard to the release of subsequent budget tranches, it will not be clear if the performance contracts are actually being enforced.

5.122 Despite these caveats, the introduction of some performance metrics into the budget process represents a clear attempt by Management to apply to its own budget processes some of the "management for results" orientation it has for a number of years been recommending to borrowers. OVE will monitor this experience closely, and continue to provide oversight notes to the Board on the implementation of this initiative in the budget process.

F. Recommendations

5.123 Development is the mission of the Bank. The development that is our mission takes place in the borrowing member countries. Demonstrating effectiveness in pursuit of this mission ought to be the principal accounting rendered by the Bank to its shareholders. Steady improvement in the effectiveness of the Bank in supporting development ought to be the principal goal of Management. These normative statements enjoy wide support within the institution, and can be found in various forms in virtually all guidance documents produced by Governors.

5.124 Delivering on these normative statements, however, require the development of capacities that the Bank has only partially acquired. These include the capacity to:

- Clearly define, through detailed analytical work, a specific meaning of "development" to be pursued in each country, sector or project
- Clearly articulate development intent in every intervention, with measurable indicators for each dimension of intent (evaluability)
- Fully specify the intended results of interventions
- Provide credible evidence of results obtained

5.125 These capacities themselves do not guarantee development effectiveness, but they are essential for generating the information to determine how effective the Bank is being in supporting development in the Region.

5.126 In this and other evaluation documents, OVE has provided evidence that the Bank's current systems, procedures and guidelines have not yet built the capacities needed to demonstrate development effectiveness. OVE has also made recommendations that have received general acceptance at the conceptual level, but which have made only slow progress in implementation.

5.127 As this evaluation report was being finalized, Management produced a draft "Development Effectiveness Framework," that appears to have accepted and expanded upon past recommendations in this area. OVE has not had an opportunity to review the document at length, but it appears to provide a basis for a substantive discussion regarding next steps for the Bank in enhancing its ability to support development.

5.128 Rather than make additional recommendations regarding development effectiveness at this point, therefore, OVE would like to use the review of development effectiveness in the past NLF to offer some suggestions as to how to approach the discussion of future efforts to improve the institution's effectiveness.

5.129 **First**, if development is that which takes place in the borrowing member countries, then the Bank's approach to the issue needs to be country-focused rather than Bank-focused. The capacities noted above need to be present in both the Bank and the countries, and there will be differences among countries. These differences need to be acknowledged and addressed.

5.130 **Second**, the resources required for developing these capacities are significant. It takes time in preparation to develop an analytical basis for each intervention, and this requires resources to collect and analyze the kinds of information needed to establish results. In the past, both time pressures and budget pressures have contributed to the slow pace of implementation of past recommendations, and it would be prudent to anticipate these needs before launching an ambitious initiative.

5.131 **Third**, the pursuit of improved development effectiveness may conflict with other institutional goals such as the volume of approvals or the speed of disbursement. Such conflicts are both inevitable and desirable, and the tradeoffs should be openly recognized.

5.132 **Fourth**, the pursuit of improved development effectiveness should be a pervasive goal throughout the institution, but it likely also requires an institutional focal point. Quality control is a key managerial function, and some mechanism is needed to vet proposed interventions for the characteristics noted above.[66]

[66] RE-260, made a specific recommendation in this area, calling *for "…a separate Development Effectiveness Assessment Unit.. would subject all projects.. to an independent review on development effectiveness issues as part of the approval process. …such a unit would also review Country Papers with a view to improving the results focus of country programming…. and review the quality of supervision in bringing about improved results during the execution process."* (Paragraph 4.47)

VI. EVALUATION INSIGHTS FOR FUTURE LENDING FRAMEWORKS

6.1 The preceding chapters have reviewed in depth the achievements of the Bank with respect to the principal recommendations of the New Lending Framework agreement. As this exercise is intended as an input to future lending framework agreements, this final chapter provides some more general comments on the nature of lending frameworks and their value for the Institution.

6.2 Lending frameworks are historical documents, designed to orient the Institution's activities within a particular context. Their value is that they indicate the views of Governors on where the Bank should be focused over the immediate future. This requires a more complete analysis of the Region's economic cycle and the behavior of other financial factors than have historically been provided in past lending frameworks.

6.3 As historical documents, lending frameworks help the Bank adjust to current conditions. Adjustment is a constant process, but past lending frameworks have operated over multi-year periods with fixed lending limits that do not encourage continuous adjustment.

6.4 Lending frameworks have in recent years substituted for replenishment agreements. Both require Management to account for past performance, and both involve the Governors in setting the future direction of the Institution. The stakes for shareholders are, of course, considerably lower in the case of lending framework agreements, and the negotiations among Governors are correspondingly less intense.

6.5 This substitution of lending frameworks for replenishment agreements has also help divert the attention of shareholders from the resource transfer problem presented in Figure 1.8. Absent an increase in lending authority produced by replenishment, the Bank becomes a permanent net taker of resources from the Region, as repayments of old principal and interest regularly outpace new disbursements. It is hard to reconcile the developmental mission of the Bank with the practice of steadily taking resources away from the Region.

6.6 The substitution of lending frameworks for replenishment agreements also helps to explain one feature common to both the 2002-2004 and the 2005-2008 lending frameworks: an extremely broad set of normative statements. Lending frameworks tend to resolve issues among shareholders by adding goals to be pursued, as this is perceived as costless. A first insight from this evaluation, however, is that goal proliferation is not costless. Every normative statement from Governors demands attention from Management, if only to produce a report at the end of the lending framework period. The length and breadth of this evaluation report provides some insight on the nature of this problem.

6.7 Another characteristic common to recent lending framework agreements is that there is no hierarchy of goals and no priorities. Nothing is clearly more important than any other thing, and the principal difference between normative statements is the degree of specificity they contain. Specificity, however, does not indicate priority. Lending category limits in the past NLF were quite specific, while development effectiveness was quite vague, yet few would argue that developmentally ineffective lending that stayed within category approval limits would be an indication of sound Institutional performance.

6.8 Goal proliferation and a lack of prioritization are also responses to a failure to resolve issues among shareholders. Shareholders failed to resolve differences over the issue of SLL vs. periodic replenishments, with negative consequences for the Bank over time. Shareholders failed to resolve differences over the issue of using national systems for managing Bank resources, but were able to endorse programmatic lending approaches that were severely compromised by inability to use local systems.

6.9 There is also a recurrent conflict between the Bank's character as a cooperative Institution and the analytic desire to discriminate between different situations. Clearly, the Bank does treat different countries differently, as is evident from the use of new lending instruments. However, when clear and transparent discrimination has been called for (certification of country systems, establishing country financing parameters), the Bank has had great difficulty, and has tended to revert to the cooperative solution of regarding all countries as the same.

6.10 A third characteristic is that thus far lending frameworks have demanded effort from Management, not results. There were no performance targets in either of the past two lending frameworks, and virtually all of the normative statements were exhortations to "work on" some objective. The substitution of effort for results creates an institutionally perverse incentive system –Management can be rewarded for expending effort in a given area, even if that effort is totally ineffective.

6.11 Finally, past lending frameworks have operated within what economist Dani Rodrik calls the "presumptive approach" to development.[67] They presume that certain activities or Institutional arrangements are desirable for all countries, and direct the Bank to work toward these "best practices." They assume the task is to generalize what we already know, rather than discover things we do not know. The "presumptive" mindset is part of the reason that the quality of the Bank's economic and sector analytic work has been low, and the nature of country programming has been diffused and over-generalized.

6.12 From these observations of past lending frameworks, the following suggestions emerge for consideration in the process of structuring the next lending framework agreement.

- **First,** the next lending framework should establish a hierarchy of objectives, starting with the objective of adding value to the economic and social development of the Region. Specific recommendations should expand on and deepen this core objective. Lending frameworks that focus on Bank

[67] Rodrik, Dani, "Spence Christens a New Washington Consensus," Economists' Voice: Berkeley Electronic Press, 2008.

instruments or lending limits take attention away from the central mission of the Bank.

- **Second,** provide a results focus to the lending framework by specifying performance objectives for the Institution over the relevant planning horizon. Then allow management flexibility to achieve these results by whatever means they determine. This places the Governors' emphasis on results rather than effort and helps reinforce the Bank's move toward becoming a performance-based Institution.

- **Third,** the Board of Executive Directors should explore thoroughly the differences in views among shareholders, and include in lending framework agreements only those normative statements on which a clear consensus exists on both the goal itself and the preconditions required for its effective realization. Including normative statements for which there is insufficient consensus on the technical prerequisites is a recipe for failure

- **Fourth,** the Realignment committed the Bank to implementing "a management model based on achieving results and managing risks." As a consequence, lending frameworks give the Governors an opportunity to both define anticipated results and provide guidance on the level and types of risk the Bank should accept. This obviously includes guidance on the balance between sovereign-guaranteed and non-sovereign guaranteed lending (missing in the last two lending frameworks), but also involves issues such as the level of liquidity desired, the desired TELR, and the risk parameters for the Bank's investment portfolio.

- **Finally,** the next lending framework should attempt to address the issue of "development risk," which is the risk that the Bank's interventions will not produce their intended results in terms of economic and social development. Accepting some development risk is required if the Institution is to help the Region move beyond the old "presumptive" approach and experiment with new solutions. But this also requires even more attention to analytical work and performance indicators to be able to learn from both successful and unsuccessful risk-taking. Taking on development risk also means differentiating one situation from another, and being able to say that what is likely to work "here" is not likely to work "there". Such an approach requires support from Governors for treating member countries differently, and doing so in an explicit and transparent fashion.