BOARD OF GOVERNORS
INTER-AMERICAN DEVELOPMENT BANK

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26 June 2013
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To: The Board of Governors

From: The Secretary

Subject: Grant Leverage Mechanism: A Proposal

At its 5 June 2013 meeting, the Board of Executive Directors agreed to present to the Board of Governors the attached proposed resolution entitled "Grant Leverage Mechanism: A Proposal."

Attached, as agreed by the Board of Executive Directors, is the document proposing the establishment of the mechanism, which is provided as reference.

The proposed resolution is submitted to the Board of Governors for consideration by the procedure for taking a vote without calling a meeting, as provided in Section 5 of the By-laws of the Inter-American Development Bank. The proposed resolution will be considered adopted on such date as the number of replies received at Bank headquarters represents a quorum pursuant to Article VIII, Section 2(e), of the Agreement Establishing the Bank, and the favorable votes cast represent a majority of the total voting power of the member countries, pursuant to Article VIII, Section 4(c), of said Agreement.

Governors may cast their votes by any rapid means of written communication, including the Governors Extranet.

The deadline for receipt of votes is 26 July 2013.

Reference: GN-2711-1(7/12), DE-55/13

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DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

GRANT LEVERAGE MECHANISM: A PROPOSAL

JUNE 2013

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ANNEX

ABBREVIATIONS

DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
EPBA	Enhanced Performance-Based Allocation
FSO	Fund for Special Operations
GLM	Grant Leverage Mechanism
GRIF	Guyana REDD+ Investment Fund
IDA	International Development Association
IDB-9	Ninth General Increase in Resources of the Inter-American Development Bank
IFF	Intermediate Financing Facility
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
NSG	Non-Sovereign Guaranteed Operations
ODA	Official Development Assistance
SGO	Sovereign Guaranteed Operations
UBC	Unused Borrowing Capacity

I. INTRODUCTION

1.1 Pursuant to Resolution AG-9/06 (Agreement on Concessional Resources of the Bank) adopted by the Board of Governors on December 21, 2006, the Bank provided for 100% relief of eligible FSO debt for Bolivia, Guyana, Haiti, Honduras and Nicaragua, effective January 1, 2007. In addition, it was determined that FSO countries (other than Haiti) will continue to have access to concessional resources via a blending of loans from the FSO and Ordinary Capital (the "OC") ("parallel loans"). Since 2007, and after the IDB-07 debt relief initiative, concessional financing at the IDB is governed by the "Debt Sustainability Framework and Enhanced Performance Based Allocation (DSF/EPBA) framework" (Document GN-24442) approved by the Board of Executive Directors on February 21, 2007. The DSF/EPBA framework is based on the principles contained in sections 3 and 4 of document CA-474-3 (Implementing multilateral debt relief and concessional finance reform at the IDB. PowerPoint presentation) and referred to in Resolution AG-3/07 (Multilateral Debt Relief and Concessional Finance Reform at the Inter-American Development Bank), adopted by the Board of Governors on March 15, 2007. Under this Framework, the overall allocation of resources to D2 countries (Bolivia, Guyana, Honduras, and Nicaragua, except Haiti) is determined by a combination of country needs and performance (the EPBA), which determines the allocation of highly concessional Fund for Special Operations (FSO) resources; and the risk of debt distress classification (stemming from the DSF), which defines the appropriate blend of Ordinary Capital (OC) resources with the individual countries' FSO allocation. As such, the total amount and the level of concessionality of Bank financing for sovereign guarantee operations available to each of these countries is determined by the DSF/EPBA under the mentioned FSO/OC blended structure. Access to OC resources outside this blended structure is currently not allowed for D2 countries due to the concessionality requirements they face as part of the path towards the consolidation of debt sustainability following the debt relief initiatives of the last fifteen years.

1.2 Concessionality requirements also constrain the D2 countries access to market-based funding sources. Moreover, D2 countries generally have a limited access to the international capital markets, and the domestic capital markets remain relatively shallow and expensive. These conditions, in a context of declining flows of concessional financing, calls for innovative approaches to maximize the financing available to the poorer countries of the region at terms and conditions consistent with the objective of preserving debt sustainability.

1.3 Donor countries have a long tradition of bilateral support in D2 countries, providing grant or concessional financing as part of their Official Development Assistance (ODA) (See Annex I). In addition, recent initiatives, originated from innovative conservation approaches, have evolved in Payments for Environmental Services (PES), which involve payments or grants from beneficiary countries of such services to those countries that provide the service[1].

[1] The participation of Guyana in the "Reduction of Carbon Emissions from Deforestation and Forest Degradation, and Conservation, Sustainable Management of Forests and Enhancement of Forest Carbon Stocks" (REDD+) Program with donations from Norway, and the establishment of the multi-donor trust fund "Guyana REDD+ Investment Fund" (GRIF) represent an example of these initiatives.

1.4 The availability of grant resources provided by donors through traditional bilateral and multilateral aid in key sectors, and/or through grant payments in exchange for environmental services, represents an important opportunity for the borrowing member countries that face concessionality requirements. Specifically, a portion of these grants could be leveraged with non-concessional resources in order to increase the total amount of funds available for development programs in D2 countries while providing a level of concessionality consistent with their debt sustainability.

1.5 The purpose of this document is to submit for the consideration of the Board of Executive Directors (Board), and subsequently the Board of Governors, Management's proposal for the establishment of a Grant Leverage Mechanism (GLM or the Mechanism) on a pilot basis to be financed with resources from the Bank's Ordinary Capital (OC) and grant resources provided by bilateral and multilateral donors in accordance with the framework, as presented in Section II.

II. THE GRANT LEVERAGE MECHANISM

A. Purpose

2.1 The purpose of the GLM is to leverage grant resources from bilateral and multilateral donors with resources from the OC to finance operations in shared priority areas, thereby increasing the concessional resources available for the recipient countries. Specifically, by combining grants with OC resources in country specific proportions, the GLM would permit tailoring concessionality levels in consistency with the Debt Sustainability Framework (DSF) while augmenting the overall financing for interventions in priority sectors in the poorest borrowing member countries of the Bank. As such, this proposal is consistent with the Ninth General Increase in Resources of the Inter-American Development Bank (IDB-9) objective of supporting small and vulnerable countries, and addresses the recent request of the Board concerning innovative ways of further supporting FSO countries beyond the limited FSO resources.

2.2 Additionally, by fostering special partnerships with potential donors and providing the incentives for working with the Bank by leveraging or "multiplying" grant resources, the GLM aims to strengthen, deepen and even harmonize interventions in a particular priority sector in consistency with debt sustainability. In general, the GLM can be viewed as a pilot for a new type of partnership between Multilateral Development Banks (MDBs), bilateral and multilateral donors and recipient countries for working with a multiplier effect in priority sectors.

B. Main Characteristics

2.3 **Country eligibility.** D2 countries (Bolivia, Guyana, Honduras, and Nicaragua), excluding Haiti[2], will be eligible to receive financing from the GLM. FSO eligible D1 countries (currently Paraguay and Guatemala) will not have access to the GLM.

2.4 **Amount and duration.** A total amount of $100 million in OC resources is proposed for the GLM. The resources will be financed from the OC regular lending program (not the

[2] Pursuant to the IDB-9 Report, Haiti will receive only grant financing through 2020.

D2 country OC allocations)[3]. The GLM will have a three-year duration from its Board of Governors approval date. A renewal of the GLM or a scaling up of the original amount allocated to it could be considered on the basis of the resource mobilization results of this pilot and the availability of funding.

2.5 **Terms and Conditions:** The OC resources that will be channeled through the GLM would have the same terms and conditions than the OC portion of the blended loans under the DSF/EPBA, namely 3-month LIBOR based lending rate (Single Currency Facility) with a 30-year maturity and 5.5-year grace period; when the outstanding disbursed amount reaches the greater of (i) 25% of the loan amount, or (ii) $3 million, the rate is fixed at the then market rate.

2.6 **Concessionality.** The appropriate degree of concessionality or grant element for D2 countries is derived from the risk of debt distress classification[4]. It is proposed that the same blend of OC and FSO loans that the Board approves for each country under the DSF/EPBA would also apply for the GLM. Each operation would thus consist of a blended grant and OC loan, which would be approved and disbursed simultaneously (*pari passu*) in order to satisfy concessionality requirements. This means that the resulting concessionality for every country under the GLM will be larger than the concessionality that each country receives under the DSF/EPBA since FSO loans have a grant element that is under 100%, currently estimated at 84.5%[5]. Table 1 presents the FSO-OC structure approved by the Board for the 2013-2014 period (document GN-2442-39). The degree of concessionality and therefore the blend used in the DSF/EPBA, and thus the blends for the GLM, will be that as determined by the Board either during the biannual allocation of FSO resources or in line with the revisions conducted by the Board (if any) to the DSF.

Table 1. Risk of Debt Distress and Current Blends (2013-2014)

	Risk of Debt Distress	Blended Structure	
		FSO	OC
Bolivia	Low	20%	80%
Guyana	Moderate	50%	50%
Honduras	Low	30%	70%
Nicaragua	Moderate	50%	50%

2.7 **Grant Eligibility.** Only grant resources from bilateral or multilateral donors available for investment lending operations and reimbursable technical cooperation operations in shared priority areas will be eligible for the Mechanism.[6]

[3] The limited size of the OC amount proposed and the expectation that the totality of the resources is not likely to be used in a single programming year would limit the impact of the Mechanism on the regular OC lending program.

[4] A Debt Sustainability Analysis (DSA) for each D2 country (except Haiti) is performed for the allocation under the DSF/EPBA to determine the appropriate blend.

[5] Calculation assuming an 84 bps lending spread for the OC and a 4.32% Base Discount Rate based on the applicable Commercial Interest Reference Rate (CIRRs), as established by the IMF methodology.

[6] Existing grants resources already administered by the Bank could be considered if the resources are made available for new eligible operations and the corresponding donor agrees on the use of resources.

2.8 **Sector and Operation Eligibility:** The GLM would fund investment lending operations and reimbursable technical cooperation operations whose objectives are consistent with the priority areas or areas of dialogue agreed with each country in the respective Country Strategy (CS). Operations in areas that are not part of the CS will be considered on a case-by-case basis if consistent with the Bank's institutional priorities and is otherwise worth of justification by its own merits.

2.9 **Mobilization instruments:** All of the Bank's resource mobilization instruments will be allowed under the GLM, namely, investment grants, project specific grants, and parallel grant co-financing.[7]

2.10 **Allocation of Resources.** OC resources channeled through the GLM will be allocated on a first-come, first-served basis among the four eligible countries. Allocation of GLM resources will be subject to: (i) inclusion of an eligible operation in the pipeline, (ii) confirmation of its consistency with the CS or IDB institutional priorities and strength of justification by its own merits, and (iii) availability of Bank technical expertise and staff resources to manage the operation. Since the GLM does not entail the use of resources from the FSO, it will be treated separately from the allocation exercise carried out every two years under the DSF/EPBA framework.

2.11 **Limits per country.** Although the quantity of OC resources needed to complement grants is determined by the blend applicable to each country, the limited amount of resources available calls for the establishment of a maximum amount of OC resources that each country could access through the GLM. A limit of $30 million during the duration of the GLM is proposed to ensure that all eligible countries could benefit from the Mechanism. Nonetheless, in order to avoid leaving OC resources unutilized, if six months prior to the termination of the GLM, as established in paragraph 2.4, a given eligible country has reached its maximum and other eligible countries will not use all GLM available resources, a proposal to provide resources to that country in excess of the established maximum per country could be presented to the Board for its consideration and approval if the matching grant resources for an eligible operation are available.

2.12 **Fees.** To cover for the administration costs of this Mechanism, especially those related to financial management reporting given the long maturity of the underlying grants, a fee of 5% of the total amount in grants that will be leveraged with OC resources in a particular operation will be charged to the donor, if the resources are administered by the Bank. If grant resources are already being administered by the Bank, no additional fee will be charged. Same criteria would apply in the case of parallel-co-financing.

2.13 **Risks.** The main risk for the implementation of the Mechanism relates to a potentially insufficient amount of grant resources from eligible donors for eligible sectors and operations. Nonetheless, in preliminary discussions, several donors have expressed interest in participating in this mechanism, if approved[8]. Moreover, the relatively limited quantity of OC resources available for the GLM, together with the respective leverage

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7 If grant resources are channeled directly from the donor to the beneficiary country through parallel co-financing, the Bank would determine in conjunction with and the agreement of the donor all necessary requirements to assure timing approval and disbursements of resources under the respective level of concessionality.

8 Donors, especially from Nordic countries, have expressed interest in participating in this Mechanism.

implied by the different blends of each eligible country suggest that there will be enough grant resources for this Mechanism.

2.14 **Resource Mobilization:** ORP/ORP in coordination with VPC/VPC and the relevant departments will make active efforts to support resource mobilization and this mechanism in particular. Following its mandate, ORP/ORP will lead the dialogue and negotiations with traditional and non-traditional donors and will disseminate and communicate the existence of this new mechanism to key actors also through ORP's regional offices in Europe and Asia**.**

2.15 **Approval of operations financed though the GLM**. Operations financed with resources of GLM will follow Bank´s policies and procedures applicable to investment lending operations and reimbursable technical cooperation operations.

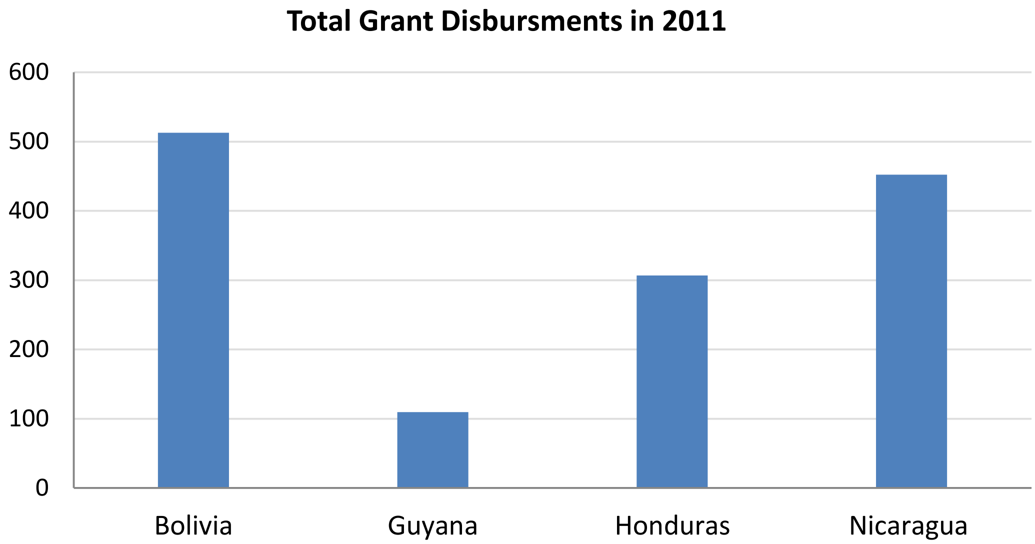
2.16 **Implementation Aspects.** Operations financed through the GLM will be treated as regular Bank operations for corporate reporting purposes and will count against all the applicable corporate targets.

III. RECOMMENDATION

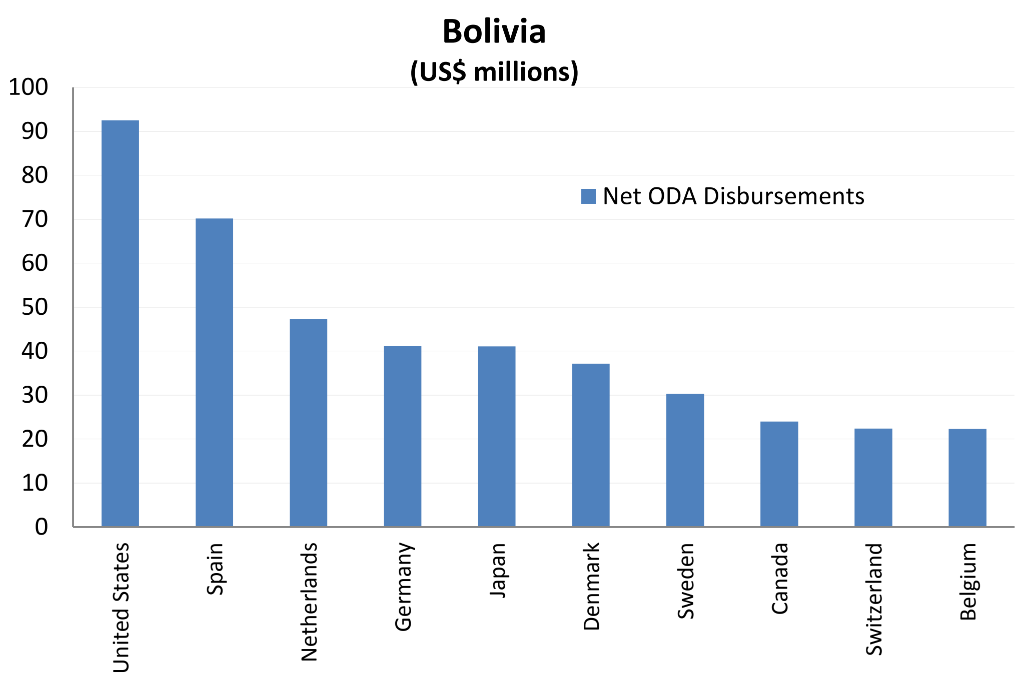
3.1 Management recommends that the Board of Governors approve the proposed resolution attached to this document.

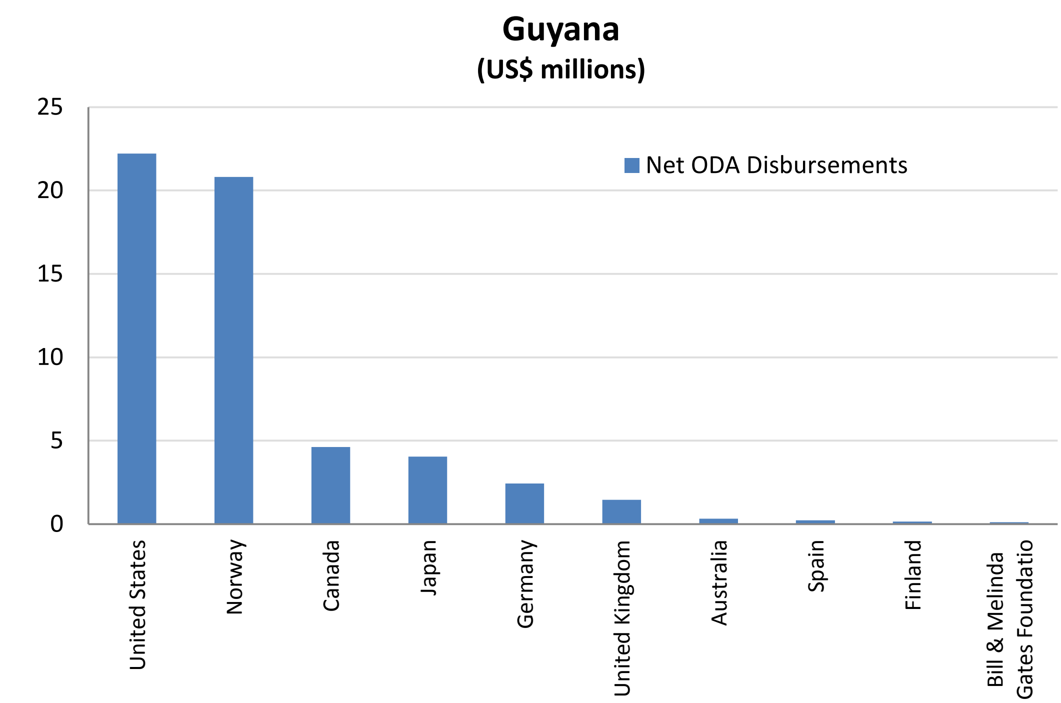
ANNEX I: ODA in D2 countries (expect Haiti)

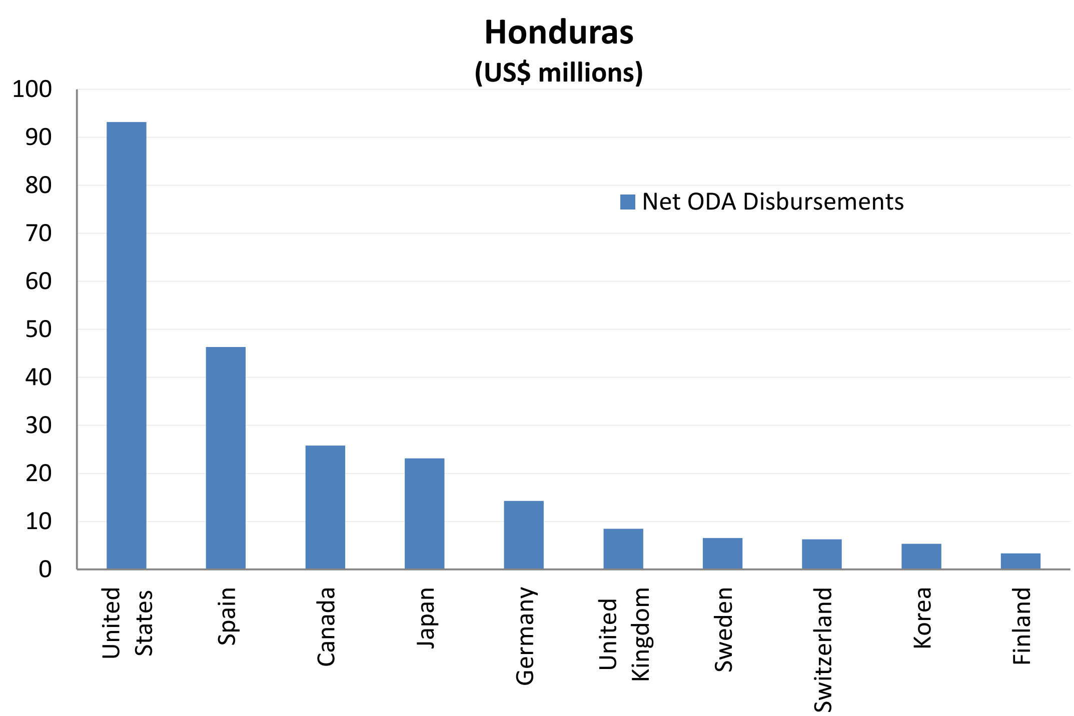
A. Total Grants disbursed during 2011, as reported to the OECD/DAC

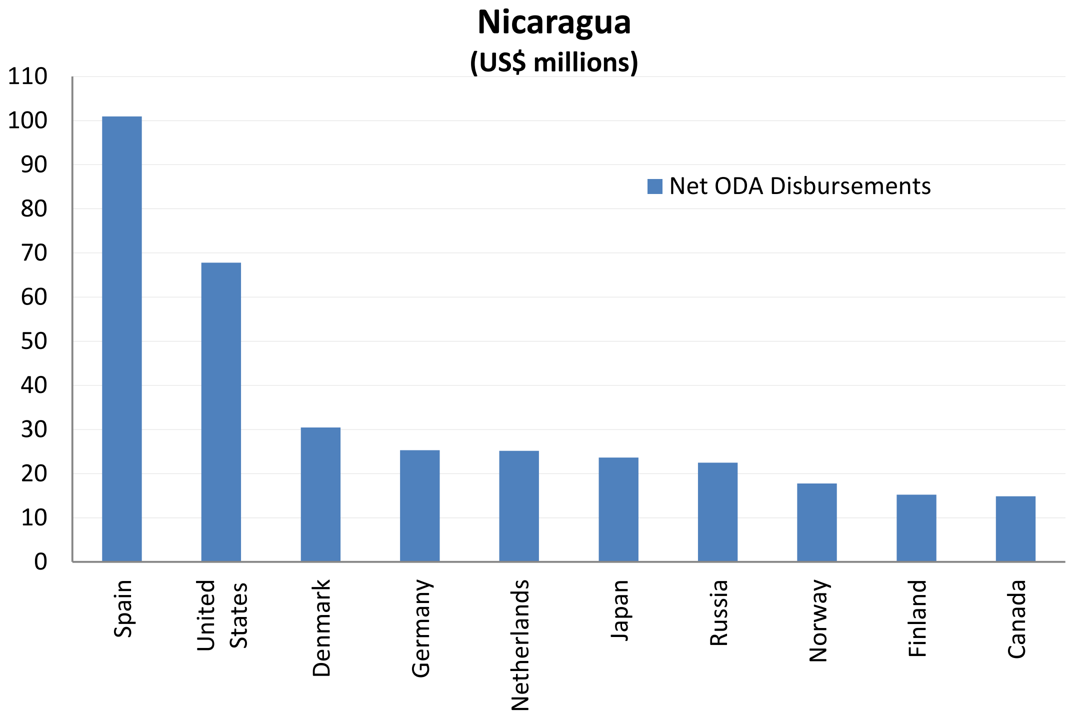


B. Bilateral ODA Composition in FSO-IV Countries:
Top 10 Donors in each country based on ODA Disbursements, as reported to the OECD/DAC (3-Year Average)




Guyana
(US$ millions)
25
20
15
10
5
0
Net ODA Disbursements
United States
Norway
Canada
Japan
Germany
United Kingdom
Australia
Spain
Finland
Bill & Melinda Gates Foundatio


Honduras
(US$ millions)
100
90
80
70
60
50
40
30
20
10
0
Net ODA Disbursements
United States
Spain
Canada
Japan
Germany
United Kingdom
Sweden
Switzerland
Korea
Finland



Nicaragua
(US$ millions)
110
100
90
80
70
60
50
40
30
20
10
0
Net ODA Disbursements
Spain
United States
Denmark
Germany
Netherlands
Japan
Russia
Norway
Finland
Canada

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION AG-__/13

Grant Leverage Mechanism: A Proposal

WHEREAS:

Pursuant to Resolution AG-9/06, entitled "Agreement on Concessional Resources of the Bank", of December 21, 2006, the Board of Governors authorized the Bank to provide for 100% relief of eligible Fund for Special Operations (the "FSO") debt for Bolivia, Guyana, Haiti, Honduras and Nicaragua, effective January 1, 2007, and that FSO countries (other than Haiti) would continue to have access to concessional resources via a blending of loans from the FSO and Ordinary Capital resources (the "OC") ("parallel loans");

Pursuant to Resolution AG-3/07 of March 15, 2007, entitled "Multilateral Debt Relief and Concessional Finance Reform at the Inter-American Development Bank", the Board of Governors approved the Report of the Committee of the Board of Governors on Multilateral Debt Relief and Concessional Resources of the Bank, which is set forth in Document CA-474-2, with the amendments contained in Resolution AG-3/07, and mandated that Management present to the Board of Executive Directors, by February 7, 2007, and the Board of Executive Directors approve no later than February 21, 2007, a proposal to implement the Debt Sustainability Framework and Performance-Based Allocation in accordance with the principles contained in Sections 3 and 4 of document CA-474-3 (the "DSF/PBA Framework");

The Board of Executive Directors approved on February 21, 2007 document GN-2442, entitled "Implementation of multilateral debt relief and concessional finance reform at the IDB. Proposal for the implementation of a Debt Sustainability (DSF) and Enhanced Performance-Based Allocation (PBA) framework";

Pursuant to the DSF/PBA Framework, the overall allocation of concessional resources is determined by a combination of country needs and performance, which determines the FSO allocation as per the Performance Based Allocation, and the level of risk of debt distress, which defines the appropriate blend of OC resources as per the Debt Sustainability Framework;

The availability of grant resources provided by donors through traditional bilateral and multilateral aid in key sectors, and/or through grant payments in exchange for environmental services, represents an important opportunity for leveraging OC resources for the borrowing member countries that face concessionality requirements, that would be additional to parallel loans previously authorized pursuant to Resolution AG-9/06; and

The Board of Executive Directors has considered document GN-2711-1 entitled "Grant Leverage Mechanism: A Proposal", and, pursuant to Resolution DE-55/13, agreed to submit for consideration of the Board of Governors this proposed resolution;

The Board of Governors

RESOLVES:

To approve the Grant Leverage Mechanism in accordance with the provisions set forth in section II of document AB-____, entitled "Grant Leverage Mechanism: A Proposal".

(Adopted on __________ 2013)