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THE NEW OPERATIONAL FRAMEWORK

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ABBREVIATIONS

ALM	Asset Liability Management
BSC	Balanced Scorecard
CCLIP	Conditional Credit Line for Investment Projects
CEP	Country Studies Committee
CHF	Swiss Francs
COF	Country Offices
COMPAS	Common Performance Assessment System
CPF	Corporate Performance Framework
CPS	Currency Pooling System
CS	Country Strategy
DAC	Development Assistance Committee
DEF	Development Effectiveness Framework
DEM	Development Effectiveness Matrix
ECCLAC	Economic Commission for Latin America and the Caribbean
ECG	Evaluation Cooperation Group
EIA	Environmental Impact Assessment
EPMF	Employee Performance Management Framework
FSO	Fund for Special Operations
FTE	Full-Time Equivalent
GDP	Gross Domestic Product
GPS	Good Practice Standards
ISDA	International SWAPs and Derivatives Association
JPY	Japanese Yen
KCP	Knowledge and Capacity-Building Products
KNL	Knowledge Department
LAC	Latin American and the Caribbean Countries
LCF	Local Currency Facility
Libor	London Interbank Offered Rate
MDBs	Multilateral Development Banks
MIF	Multilateral Investment Fund
NLF	New Lending Framework
NOF	New Operational Framework
NSG	Non-Sovereign Guarantees
NSO	National Statistical Office
NSS	National Statistical System
OC	Ordinary Capital
OLB	Outstanding Loan Balance
OVE	Office of Evaluation and Oversight
PBL	Policy Based Lending
PDL	Performance Driven Loans
PEFA	Expenditure and Financial Accountability
PIUs	Project Implementation Units
PMR	Project Monitoring Report
RES	Department of Research and Chief Economist

RMG	Risk Management Group
SCF	Single Currency Facility
SECCI	Sustainable Energy and Climate Change Initiative
SG	Sovereign Guarantee Loans
SLL	Sustainable Lending Level
SPD	Strategic Planning and Development Effectiveness Department
STFs	Strategic Thematic Funds
TA	Technical Assistance
TELR	Total-Equity-to-Loans Ratio
TRS	Time Recording System
VPs	Vice-Presidencies

EXECUTIVE SUMMARY

In the past five years, macroeconomic performance in Latin America and the Caribbean (LAC) has been strong, access to international and domestic sources of financing has expanded, and several of the Bank's borrowing member countries have achieved an investment grade credit rating. However, the financial markets crisis experienced in the United States and Europe in the last few months threatens to drive the region into a sharp economic recession as commodity prices fall, access to credit and export markets tightens and growth in developed countries declines. This context creates new challenges for LAC which involve preserving the gains in macroeconomic management achieved thus far, consolidating advances in social programs, and strengthening or creating new social programs to protect the poor.

In the current international environment, it is more important than ever for the Bank to sharpen its focus on development results and accountability and better allocate resources among competing demands. Borrowers need financial, and knowledge and capacity-building products that not only allow them to fund policy programs, but to design and implement them more effectively. At the same time, some of the Bank's clients are looking less for a source of financing than a supplier of direct knowledge or capacity-building products. As country financial management, procurement and environmental protection systems improve, borrowing member countries are questioning the need to rely on the procedures of MDBs or donors.

For the IDB to remain relevant in the region, it must adjust to these developments. It must stand prepared to help borrowing member countries face the social and economic challenges resulting from the current global financial market crisis, and play a countercyclical role. The Bank needs to adapt its products and practices to further strengthen its focus on development effectiveness, and provide financial and knowledge and capacity building products that better serve the needs of the region and help countries manage financial risks better. Moreover, the private sector has become the most important investment force in the region, so maximizing development impact requires the Bank to go beyond its traditional client base and product mix.

The Realignment approved by the Board of Executive Directors in 2006 provided an organizational structure to position the Bank to address these developments more effectively. This document advances further by: (a) updating the 1999 *Institutional Strategy* (GN-2077-1) based on shifting regional trends and new challenges for the Bank; (b) proposing an annual programming process that amends the four-year lending envelope approach of the *New Lending Framework* currently in effect; and (c) providing context on several initiatives under development to improve the way the Bank offers its operational program.

The NOF updates the 1999 *Institutional Strategy* by identifying the priority areas for the Bank's involvement in the coming years. These include: social policy for equity and productivity; infrastructure for competitiveness and social welfare; institutions for growth and social welfare; competitive regional and global international integration; and protecting the environment and responding to climate change. The NOF also lays out an

agenda for updating the Bank's financial and nonfinancial products, processes and mechanisms that: (a) provides the Bank with the tools to better serve the development needs of the region in the coming years; (b) takes advantage of the client focus and sector specialization brought about by the Realignment; and (c) enhances the Bank's capacity to measure and manage risk.

Specifically, the NOF focuses on five key areas:

- *First*, it affirms the Bank's commitment to development effectiveness in all activities – sovereign and non-sovereign guaranteed interventions, Country Strategies, and knowledge and capacity-building products – by remediating existing deficiencies and generating a new Development Effectiveness Framework for the Bank consistent with international standards. This Development Effectiveness Framework has already been approved by the Board of Executive Directors.
- *Second*, the NOF summarizes plans to augment the added value of the Bank's financial and knowledge and capacity-building products by better aligning them with client needs. It presents a framework to develop a broad selection of market-standard financial instruments that would enable borrowers to improve management of their liabilities. Knowledge and capacity-building products should become a core business of the Bank – comparable to sovereign and non-sovereign guaranteed financing. The NOF summarizes a proposal for a platform to plan, manage, monitor, evaluate, and sustainably finance these products.
- *Third*, it advocates a stronger emphasis on strengthening and using country systems as a means to enhance development effectiveness and country focus, and make dealings with the IDB less burdensome. This document summarizes the way Management proposes to carry out this task.
- *Fourth*, the NOF stresses the need to improve the Bank's analytical capacity to manage its capital prudently and efficiently. This is of particular importance in light of the risks exposed by the current global financial crisis. The Bank needs to review and update its current capital adequacy framework over the next year in order to align it with current best business practices, and enable it to support decision-making on allocating capital among the Bank's business lines.
- *Fifth*, the NOF proposes that the Board of Executive Directors set a rolling two-year lending program based on estimated demand and the Bank's capacity to support high impact interventions. Every year, Management would re-estimate the development opportunities for the next two years, and present, for approval of the Board of Executive Directors, the operational program to meet this demand. The NOF also proposes that the Bank operate without lending category sub-ceilings in order to allow adjustments to the lending program to address the changing needs of borrowers in a timely fashion.

The NOF sets forth two recommendations to be approved by the Board of Governors. They are:

Recommendation 1: *Eliminate the requirement that the Board of Governors determine Bank lending limits for four-year periods and sub ceilings by category of lending.* The Bank should continue supporting borrowing member countries through the three basic lending categories (Investment Lending, Policy-Based Lending and Emergency Lending) and others that may be created in the future. The sub-ceilings on lending categories should be eliminated so that lending volumes and types can be adjusted based on the evolving needs of the region, subject to Charter and policy restrictions.

Accordingly, the provisions of the Agreement on Measures for Enhancing the Response Capacity of the Inter-American Development Bank set forth in the Annex to Resolution AG-1/02, as amended, would remain in effect, except for the following modifications: (a) the Board of Executive Directors may create new categories of lending in the future; (b) the requirement that the Board of Governors determine lending limits for four-year consecutive periods would be eliminated, and beginning 1 January, 2009, the Bank's lending volumes for all categories of lending would be determined by the Board of Executive Directors¹; and (c) the limitation on the revolving aggregate amount of the Ordinary Capital resources that may be approved for Emergency Loans would be eliminated and, beginning on 1 January of 2009, the availability of resources for these loans would be determined by the Board of Executive Directors. Any decision adopted by the Board of Executive Directors regarding new lending categories or the Bank's lending volumes shall at all times be consistent with the limitations established in the Charter and applicable Bank policies, including limitations on lending, categories of operations, limitations on borrowings and other applicable requirements.

Recommendation 2: *Conduct a review of the implementation of the New Operational Framework.* This review will be prepared for consideration by the Board of Governors at the Annual Meeting of the Board of Governors in 2014.

¹This recommendation does not include a proposal to delegate to the Board of Executive Directors the authority to modify the limitations for non-sovereign guaranteed operations as set forth in Board of Governors Resolution AG-5/06.

I. INTRODUCTION

A. Background

- 1.1 The strategic framework of the Bank has, since its creation in 1959, been based on: (a) the *Agreement Establishing the Inter-American Development Bank*² (the Charter, as amended), which defines the Bank's mandate and functions, and provides broad guidance on how the Bank's business should be conducted; (b) periodic replenishment agreements reached by Bank shareholders, which have provided new resources and set priorities and targets for multiyear periods; and (c) policy decisions made by the Board of Governors and the Board of Executive Directors in the course of regular Bank business.
- 1.2 In 1994 the Governors approved the Bank's Eighth Replenishment.³ Until then replenishment negotiations had provided recurring opportunities for all Bank shareholders to review strategic goals and objectives, and to discuss approaches required to meet the changing needs of borrowing member countries. The discontinuation of periodic replenishments resulted in an institutional vacuum that has been filled over time with various strategic undertakings.
- 1.3 First came the 1999 Institutional Strategy, aimed at bridging the gap between the mandates of the Bank's Charter and the *Eighth Replenishment* on the one hand, and the evolving needs of borrowing member countries on the other. It took stock of the Bank's strengths and weaknesses, and identified its areas of comparative advantage, recommending the approval of the "2+4+1" Bank strategies.⁴ The second undertaking involved the lending frameworks approved by the Board of Governors, which covered two consecutive periods from 2002–04⁵ to 2005–08.⁶ The *2005–08 New Lending Framework* is an essential, although implicit, element of the Bank's current strategic framework. It frames the financial and operational aspects of the Bank's work, and, as a result, has a major impact on the Bank's relevance for Latin America and the Caribbean.
- 1.4 More recently, the Bank has taken a number of important steps that have had a strong impact on the way it conducts its day-to-day operations. First, in December 2006, the Board of Executive Directors approved Management's Realignment proposal, which had "two basic objectives: (a) to increase the

² The link <http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=190196> provides the 1996 version of the agreement, which reflects the amendments approved by the Board of Governors after the IDB's Eighth Replenishment.

³ See <http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=165687>, *Report on the Eighth General Increase in the Resources of the Inter-American Development Bank* (Doc. AB-1704 of 12 August 1994).

⁴ See <http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=71592>, *Integrated Strategy Implementation Plan* (Doc. GN-2195-3 of 13 June 2003).

⁵ See <http://idbdocs.iadb.org/WSDocs/getDocument.aspx?docnum=574486>, *Agreement on Measures for Enhancing the Response Capacity of the Inter-American Development Bank*, adopted on March 1, 2002, by Resolution AG-1/02 of the Board of Governors.

⁶ See <http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=513860>, *New Lending Framework (NLF): Assessment Report and Recommendations, final version* (Doc. GN-2200-13 of 1 April 2005).

development effectiveness of Bank activities by means of greater country focus, deeper sector expertise, and improved management based on risk and attainment of results; and (b) to increase organizational efficiency through better corporate integration of operations and scaling up the various functions.”⁷ Second, in 2006 the Board of Governors expanded the Bank’s mandate for non-sovereign guaranteed operations to sub-national entities as well as to a wider range of economic sectors.⁸ Third, the Board of Executive Directors approved three sector-specific initiatives, namely the Sustainable Energy and Climate Change Initiative (SECCI),⁹ the Opportunities for the Majority Initiative,¹⁰ and the Water and Sanitation Initiative.¹¹

B. Purpose of This Document

- 1.5 As the previous account indicates, the Bank’s current strategic guidance includes, in addition to the Charter, a number of decisions made independently over the past 10 years. Although there is a considerable degree of consistency between the above-mentioned strategic undertakings, there is a risk that their various objectives, scopes, and time frames might not provide the clear-cut strategic direction the Bank now requires. It is therefore essential that the IDB take steps toward greater clarity and coherence, and provide future strategic guidance in a single document. The Bank’s 50th anniversary next year provides an excellent opportunity to review the main development challenges confronting the region, and propose a strategic approach for the coming years.
- 1.6 The purpose of this report is: (a) to update the 1999 *Institutional Strategy* (GN-2077-1) based on the shifting regional trends and new challenges confronting the Bank; (b) to propose an annual programming process that amends the four-year lending envelope approach of the *New Lending Framework* currently in effect; and (c) to provide context on several initiatives under development to improve the way the Bank implements its operational program. The initiatives described in the New Operational Framework will be developed and implemented over time, and facilitated by the numerous changes already introduced at the Bank since the Realignment. The NOF components will be developed in specific policy proposals that will be submitted to the Board of Executive Directors over the next three years.

⁷ See <http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=966609>, *Realignment of the Bank to Take on Its Strategic Challenges* (Doc. GA-232 of 7 November 2006, Introduction).

⁸ See <http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=776722>, *Operational Guidelines for Non-Sovereign Guaranteed Operations, revised version* (Doc. GN-2400-11 of 1 August 2006).

⁹ See <http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=907910>, *Sustainable Energy and Climate Change Initiative, revised version* (Doc. GN-2435-1 of 20 February 2007).

¹⁰ See <http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=776722>, *Opportunities for the Majority* (Doc. GN-2430-4 of 6 March 2007).

¹¹ See <http://idbdocs.iadb.org/WSDocs/getDocument.aspx?DOCNUM=976896>, *Water and Sanitation Initiative, new revised version* (Doc. GN-2446-2 of 14 May 2007).

C. Structure and Contents

- 1.7 Chapter II discusses the changes in the international context and the key development challenges facing the region today. On this basis, it defines the Bank's challenges and institutional priorities going forward. Chapters III to VII elaborate on the five components of the New Operational Framework (NOF): strengthening development effectiveness; high-value products aligned with client needs; build-up and use of country systems; improved efficiency of the Bank's capital management; and management of lending limits and sub-ceilings. Chapter VIII presents the recommendations proposed for approval by the Board of Governors. Annex 1-A and 1-B presents the Proposed Resolutions. Annex 2 provides a preliminary implementation plan of the NOF and explains how its implementation will be monitored. Annex 3 describes how Management has addressed the recommendations made by the Oversight and Evaluation Office (OVE) on the 2005-2008 New Lending Framework (NLF), and Annex 4 presents data on lending and net flows during the 2005-2008 NLF period.

II. KEY CHALLENGES FOR THE DEVELOPMENT OF LAC AND IDB INSTITUTIONAL PRIORITIES

A. Changes in the International Context

- 2.1 Since August 2007, the international environment has turned progressively less favorable, inevitably affecting the region through changes in commodity prices and access to credit and export markets. In September 2008 the unprecedented uncertainty and volatility experienced in the United States and Europe had noticeable negative effects on financial variables in the region. It is too early to gauge whether measures recently taken by the authorities in the United States and Europe to strengthen their financial systems will be sufficient to avert a more severe crisis, and consequently avoid a longer lasting financial contagion in Latin America and the Caribbean. Nevertheless, it is clear that the world will face a period of very slow growth in the months ahead. Under more pessimistic scenarios, the period of slow growth will be more long lasting, and may be characterized by recurrent financial disruptions and significant difficulties for some to access credit.
- 2.2 This context is creating new challenges for the region, two of which need to be highlighted here. The first involves preserving the gains in macroeconomic management achieved thus far in order to be able to resume faster growth once the unfavorable period ends. This will be a difficult task given the heightened international volatility and uncertainty, and the depth and duration of the recessionary environment caused by the financial crisis. The second challenge involves consolidating advances in social programs. This is also a difficult task since reduced growth will increase fiscal pressures and will likely require

strengthening or creating new social programs to protect the poor and vulnerable segments of the population.

- 2.3 Apart from the current global crisis, the IDB faces a very different world from the one it confronted at its inception. Globalization has integrated world markets for goods and services, accelerated movements of capital beyond national borders, and increased availability of better technologies. The expansion of trade has been a major determinant of growth worldwide. Many countries have carried out structural reforms to facilitate the exchange of goods and services and have signed sub-regional and bilateral trade agreements. The accelerated growth of Asian countries has created a new reality for Latin America and the Caribbean (LAC): trade volumes across the Pacific today are greater than those across the Atlantic.
- 2.4 Despite the large growth in trade, the world is characterized by large income inequalities across countries, giving an unprecedented impetus to the physical movement of people. Average per capita income in the five richest countries is 100 times greater than in the five poorest. This gap implies that international migration will play a significant role in future years. In many countries in Latin America and the Caribbean, remittances have overtaken the volume of official development aid and constitute the main source of financial resources other than foreign direct investment.
- 2.5 In parallel, unprecedented volumes of capital are moving across borders, creating new opportunities for investors but also at times greater volatility. On the one hand, sovereign governments and the private sector are actively parsing opportunities in global financial markets to obtain credit; on the other hand, new investors –like sovereign funds and pension funds –are reshaping the global financial landscape. Latin American and Caribbean countries today are as inexorably tied to world capital markets as they are to markets for goods and services.
- 2.6 At the same time, over the past years the world has taken stock of the impact of human activity on the earth's climate. Climate change might cause floods and droughts in Andean watersheds, significant losses of housing and land to tropical storms and rising sea levels in the Caribbean, important biodiversity losses in the Amazon basin, and expansion of malaria and dengue fever into new geographic areas – all with unprecedented social and economic implications. This issue has acquired a global nature without there being fully developed governance structures to tackle it. In order to address this and other supranational issues like capital movements and migration, international institutions will have to strengthen their capacity to deal with new challenges, while adapting their functioning to the reality of a radically different world. At 50, this is the challenge for the IDB.

B. A Shifting Context in Latin America and the Caribbean

- 2.7 The past five years have witnessed significant improvements in the region's macroeconomic performance. The average annual rate of growth of the region's

GDP for the period 2003-2007, 4.8 percent, was the highest observed for a five-year consecutive period in the past 27 years. Faster growth has also been accompanied by lower inflation. For the same period, the region's average annual inflation rate was 6.8 percent, one of the lowest in the past four decades. The region has also witnessed reduced current account and fiscal deficits.

- 2.8 These trends are not homogeneous for all countries, nor have all improvements been solely the result of national efforts. Up to mid-2007, the region benefited from an unusually favorable external environment characterized by high prices for many of its export products, increased world savings, and rapid world growth, which was partly responsible for the region's improved performance.¹² At the same time, many countries in the region – among them, those with the largest GDPs– made structural improvements in macroeconomic management. This is reflected in the enhanced autonomy of central banks, adoption of fiscal responsibility laws, improved business climate, and related measures. At the end of the day, these and other institutional changes are a reflection of a greater societal consensus in favor of economic stability, and a wider awareness that prudent macroeconomic management is a necessary input for sustained development.
- 2.9 The region has also turned in the direction of democracy. The process of far-reaching political transformations that started in the late 1970s and gained momentum in the 1990s continues to the present day. This movement toward democracy has been broader, more deeply engrained, and longer lasting than any in the region's history. The foundations have been set for further citizen mobilization and organization, raising in turn new challenges. Democracy is raising citizens' expectations to receive more and better quality public services and demands for more transparent, efficient, and flexible forms of governance. It is also decentralizing resources and responsibilities to sub-national governments, creating new channels for participation, and changing the way in which some basic services are delivered. Democracy is also changing the way policies are debated, legislated, and implemented, a process that extends to development policies, broadly defined.
- 2.10 Although democracy has expanded, the region remains marked by extensive inequality. Democracy has brought increased voice to segments of the population that historically have been excluded from the benefits of development. Still, most countries in the region battle with inequality of opportunities in a wide variety of aspects, from education, to credit, to land titling. The resiliency of inequality in Latin America requires not only political leadership, but also the development of inclusive institutions. In addition, democracy will face important challenges in the coming years, as the region faces the negative economic consequences of the current international financial crisis. It is critical for LAC to preserve and strengthen the gains in democracy achieved thus far.

¹² See the report by the IDB's Research Department, "All That Glitters May Not Be Gold: Assessing Latin America's Recent Macroeconomic Performance," April, 2008.

- 2.11 On the external front, in the last decade or so most countries in the region have embraced policies aimed at integration into the world economy. Now countries need to focus their attention on complementary domestic agendas that build their competitiveness in order to effectively compete internationally. Further, the case could be made that the region has not taken full advantage of the growth in world trade, and that in some countries protectionist tendencies are emerging. At times there is a perception that the benefits of market opening have not been distributed equitably across social groups and regions, potentially generating the risk of a backlash against global integration. Countries in the region need to increase their regional and global competitiveness while ensuring a more equitable distribution of the gains from trade.

C. New Challenges for the IDB

- 2.12 This qualitatively different context creates new challenges for the IDB. Thanks to good macroeconomic management, many of the Bank's borrowers have had greater access to international credit from sources other than multilateral development banks (a few having reached investment grade). Their debt management policies have shifted toward reducing currency and interest rate exposures. This situation may change in the coming months depending on the dénouement of the world financial crisis. However, it is to be expected that after the crisis is over, and assuming stability is preserved, such access will return. In this context, the IDB needs to adapt its products and practices to help countries manage financial risks better. This includes providing market-standard products so that they can hedge risks more easily.
- 2.13 At the same time, the Bank must stand prepared to play a countercyclical role during periods of financial stress. The rapid response of the IDB to the current financial turmoil in global markets through the new Liquidity Program for Growth Sustainability in the context of the Bank's Emergency Lending Facility, is a good example of this practice. Depending on the evolution of future events, the Bank may need to show further flexibility, velocity and adaptability to rapidly changing international conditions.
- 2.14 Notwithstanding the current international context and its impact on credit availability, our shareholders demand greater focus on development results and accountability. This is consistent with our clients' demand for financial and knowledge and capacity-building products that allow them not only to fund their policy programs, but to design and implement them effectively. Some borrowers are looking less for a source of financing than a supplier of direct knowledge or capacity-building products. Finally, as their financial management, procurement and environmental protection systems improve, countries question the need to rely on the procedures of MDBs or donors. Adopting and improving country systems is not only a way to reduce transaction costs for the borrowers, but also a recognition that endogenous institutional capacity is a key dimension of economic and social development.

D. Setting Institutional Priorities

- 2.15 A critical observation in setting institutional priorities is that macroeconomic stability has by-and-large not translated into fast growth. The region's recent average growth rate, although better than its past performance, is low compared with other emerging regions of the world. Not only are the growth and investment rates low by international standards, but the same appears with indicators regarding labor training, innovation, and adoption of new technologies – all factors that are critical for sustaining increased productivity and long-run growth. Another critical observation is that the region still occupies the unenviable position of having some of the most unequal distributions of income and wealth in the world. Yet a third critical observation is that the region, along with the rest of the world, must face the relatively new issues associated with environmental sustainability and climate change. If the region's challenge were to be put in a nutshell, it would center on the need to maintain and strengthen macroeconomic stability during these turbulent times while, on the one hand, tackling the structural factors that account for low productivity growth and persistent inequality of opportunities; and, on the other hand, charting growth paths consistent with preserving the environment and avoiding global warming. These three observations translate into five institutional priorities for the IDB as it supports its sovereign and non-sovereign clients in the years ahead.

1. Social Policy for Equity and Productivity

- 2.16 In the past decade, the region has experienced a reduction in poverty. This outcome derives partly from increased macroeconomic stability and growth, and partly from a new generation of poverty alleviation programs that transfer income to households more effectively than previous programs did. Despite these advances, the region is still characterized by unusually high poverty rates, given its average income per capita. High poverty rates in part reflect high income inequality, and in some cases are accompanied by worrisome nutritional indicators. In fact, if income inequality were reduced to that observed in emerging countries from other regions, poverty and under-nutrition rates would be noticeably lower.
- 2.17 Education is a critical sector for development, and one where regional outcomes are mixed. Although coverage has increased, particularly at the primary level, on the whole, Latin American and Caribbean countries compare unfavorably with other emerging countries with regard to quality. Further, prevailing high grade repetition reduces the probability that children transition and successfully complete secondary education. These outcomes occur despite increasing fiscal resources, suggesting the presence of profound structural factors that hamper this sector.
- 2.18 The region's labor markets are also a source of deep concern. Despite faster growth, in many countries more than half of the labor force is informally employed, implying low coverage of pension systems and insurance against

disability, work, or life risks. Low coverage of social security also usually translates into limited access to health insurance. Informality is particularly prevalent among low-income workers, urban or rural.

- 2.19 The social challenges facing the region are large, particularly given its rapid demographic and epidemiological transition. These challenges cannot be addressed by simply increasing social spending subject to a fiscal constraint. In some countries, social policy runs the risk of becoming little more than the accumulation of an increasingly large but disjointed set of programs, which may inadvertently be taxing formal employment and subsidizing informal employment. To successfully address the region's social challenges, social programs need to pay careful attention to the way they affect the behavior of firms and workers in the labor market. More generally, the pursuit of equity through various social programs needs to go hand-in-hand with the pursuit of productivity if gains are to be sustained and accumulated over time. That is why further advances in poverty reduction need to be anchored in greater worker productivity and not increased monetary transfers. Reductions in income inequality achieved by transfers and similar redistributive policies have limits that can be surpassed only through processes that systematically improve economic outcomes, by increasing workers' levels of education and health, and making credit and labor markets function better. This is the case for all workers, but is particularly so for groups that have been traditionally underserved, such as women, indigenous, and Afro-descendants.
- 2.20 The region urgently needs a new generation of social programs to increase the quality and relevance of education, protect households against risks, redistribute income effectively, and, at the same time, foster increases in productivity. In particular, because economic growth is essential for sustained poverty reduction, the region needs social programs that contribute to make countries' labor markets perform more effectively, as judged by their capacity to create jobs with higher wages and social security coverage. Critical questions in this context are how to achieve successful school-to-work transitions, how to foster formal employment, how to finance universal health and pension benefits, and how to design effective training programs, among others. Better functioning labor markets are not only essential for raising productivity and wages; they are perhaps the most powerful tool to augment gender equality and combat discrimination, dimensions of social life in which the region needs to advance more decisively.

2. Infrastructure for Competitiveness and Social Welfare

- 2.21 Low levels of physical infrastructure are an unfortunate inheritance of many years of macroeconomic instability and fiscal crises. This situation puts the region in a distinct competitive disadvantage vis-à-vis other regions of the world. Compensating this disadvantage with lower real wages is not only inequitable, but also unsustainable. More likely than not, social and political pressures will lead governments to compensate low real wages with redistributive measures that create further fiscal pressures and, depending on their design, can also negatively

affect workers' and firms' incentives in the labor market, further depressing countries' competitiveness. Even if this is not the case, fiscal resources channeled to increase households' current consumption through various transfer and subsidy programs are fiscal resources not channeled to public investments in infrastructure, which are essential inputs to raise households' future productivity, income, and consumption.

- 2.22 Given the many years of substantial underinvestment in productive infrastructure, and the high rates at which countries in Asia and other regions of the world are investing, it is imperative that countries in the region rapidly raise their investments in infrastructure. Transportation --ports, highways, airports, railroads -- is a critical area, given the large positive externalities associated with low transport costs and the importance of a dense network for balanced regional development. In fact, as a result of the various trade agreements currently in place in the region, in many cases transport costs are now more important than tariffs and other trade measures in determining trade flows and countries' revealed comparative advantages. That is why improved transport infrastructure is almost equivalent to improved competitiveness. Lags in transport infrastructure are also partly responsible for the geographical isolation of entire communities, especially indigenous and Afro-descendants, further creating conditions for low productivity, lack of competitiveness, and poverty. Infrastructure investments are also essential to raise the productivity of specific sectors of the economy, like agriculture, especially in countries that have large natural comparative advantages in this sector.
- 2.23 Lags in infrastructure investments also negatively affect households' welfare. A particularly important example is access to water and sanitation, given their relevance for health and nutrition. Another example is access to low-cost and reliable telecommunications, which can have large positive spill-over effects into education and households' standard of living. Differently put, increased investments in infrastructure contribute to raising labor and capital productivity, but also have a direct effect on households' welfare.
- 2.24 More investment resources are not enough, however. Projects need to be executed in a proper regulatory framework; they also need to mix private and public resources efficiently. Experience shows that incentives for performance are critical, as is the right distribution of risks between the government, lenders, and those in charge of executing projects. Private-public partnerships need to be carefully crafted to avoid the types of situations that were unfortunately observed in some countries in the past, where successful projects generated private profits, and unsuccessful ones public liabilities. Public concessions also need to be granted in contexts characterized by transparency and competitive access.

3. Institutions for Growth and Social Welfare

- 2.25 Sustainable and equitable development requires more than investments in human and physical capital; strong and effective institutions are also determining factors.

The link between institutions and development is manifested through various interconnections: providing a regulatory framework that supports the functioning of markets; ensuring a stable macroeconomic environment; and legal predictability and security, among others. There is ample evidence that the countries that have benefited the most from economic reforms are those that have advanced the most in implementing successful institutional reforms.

- 2.26 Although there have been advances, progress remains uneven and many countries in the region continue to be affected by weak institutions, at both the national and sub-national levels. Unfortunately, the region abounds with examples where insufficient attention to institutions and to governments' capabilities to implement policies has resulted in negative outcomes. More generally, experience shows that well designed but badly implemented policies can be as counterproductive as bad policies themselves.
- 2.27 The international community has renewed, in Accra, its commitment toward the build-up and use of country systems, in particular, those systems at the core of the management-for-results agenda, such as in the financial, budgetary, and procurement areas. The Bank has developed a solid track record of capacity build-up in these areas. One example is the budgetary process, where efficient interaction between the Executive and the Legislative branches of government requires broad access to information and institutions to enforce accountability when socially harmful behavior is observed.
- 2.28 A related example concerns the budgetary relationships between different levels of government. A successful decentralization process from national to sub-national governments requires not only the right balance between the functions decentralized and the resources transferred for these purposes, but also the existence of sub-national institutions that operate under a framework of transparency and accountability.
- 2.29 Another example is credit. An efficient credit market requires judicial institutions to enforce contracts at relatively low cost, modern bankruptcy laws, public property registries, and credit bureaus that provide credible information to lenders on households' and firms' balance sheets. In countries where these institutions are weak, financial intermediation is low and commercial credit to firms, particularly small and medium-size ones, is erratic and expensive, with negative implications for competitiveness and growth. Unfortunately, this is the case in many countries of the region. The presence of large informal sectors raises additional challenges, as many firms are not legally registered as such, and have assets that cannot be pledged as collateral. Appropriately regulated development banks can complement private credit markets, but cannot substitute for them; in the end, strong private sector institutions and effective regulatory capabilities are indispensable for the development of credit markets in particular and financial markets more generally.

- 2.30 Yet another example concerns the institutions and capabilities required to foster innovation and the adoption of new technologies. These factors are essential inputs to increase productivity growth, but require institutions that can properly defend patents and intellectual property rights, promote public-private partnerships for research and development, and create predictable environments where firms can make medium-term commitments to the introduction or adoption of new processes and products.
- 2.31 Strong institutions and capabilities are essential not only for economic growth in a narrow sense, but also for the functioning of core government responsibilities that matter greatly for social welfare. Examples include: institutions responsible for citizens' security; institutions in charge of citizen registration--which is indispensable for access to social programs and for a sense of social inclusion--; and the institutions responsible for gathering and publishing country social and economic data. All three areas also exemplify situations where institutional weaknesses tend to disproportionately affect women, indigenous, and Afro-descendants, whose plight at times is under-reported in official statistics.

4. Competitive Regional and Global International Integration

- 2.32 Over the past two decades, most countries in the region have signed and implemented important and comprehensive multilateral and regional trade agreements; others have pursued unilateral commercial liberalization. Shares of exports and imports in GDP have increased, and trade has diversified in the region and vis-à-vis the rest of the world. Trade integration has exposed countries to more intense competitive pressures and unleashed forces to increase static and dynamic efficiency. As a result, Latin American and Caribbean households now have access to a broader range of consumer goods than in the past, with improved price-quality combinations; the same is true with regard to firms' access to intermediate inputs. Moreover, in some cases, trade agreements include provisions to solve cross-country investment disputes, lowering transactions costs and uncertainty for foreign direct investment in the region. Nevertheless, trade performance is still lackluster compared with that of developing countries in Asia, and the structure of regional exports is still dominated by low value added commodities.
- 2.33 Hence, there are further gains to be exploited, as integration extends to goods and services not traded before, and from trade flows to capital and labor flows; the region has much to gain from deepened integration, within itself and with the rest of the world. In parallel, the region needs to urgently address the unfinished business of implementing the wide array of trade agreements that have been signed or are currently under negotiation. Failing to invest in areas such as the administration and potential harmonization of rules of origin, customs procedures, sanitary and technical standards, and, more generally, in upgrading trade-related institutions will undermine the benefits of market opening. This traditional agenda also needs to be expanded to new issues associated with trade in services such as technical know-how and financial flows, and protection of investments

and intellectual property, among others. Further, migration of workers in the region will most likely accelerate in the years ahead, as has been observed, for example, in the European Union, where integration is more advanced.

- 2.34 This new integration agenda opens novel areas of work for the IDB with borrowing countries. Some examples give a sense of the challenges ahead: designing convergence mechanisms among existing bilateral and regional trade investment agreements; designing regulations for efficient intra-country and international trade in financial products; promoting the deepening of countries' local currency markets; designing appropriate regional investment and competition regulatory frameworks in key service sectors like telecommunications; designing and executing infrastructure projects in transportation, energy, or water jointly between two or more countries; coordinating fiscal systems between countries to avoid predatory competition for foreign investments; reforming national pension systems to recognize contributions from workers who work in different countries; and coordinating efforts to respond to natural disasters, be they to carry out preventive and mitigation measures spanning more than one country, or to diversify risks more efficiently. Moreover, it is crucial to ensure that gains from this regional and global integration agenda are distributed equitably across regions and social groups by designing and implementing policies that are comprehensive, domestic, and complementary to support displaced workers and promote intra-country regional convergence.

5. Protecting the Environment and Responding to Climate Change

- 2.35 Latin America and the Caribbean shares with the rest of the world the responsibility to respond to what arguably is the largest challenge faced by humanity in this century: developing a sustainable relationship with the environment and dealing with climate change. The challenges here are vast because the processes that modify the world's climate and degrade its natural environment are characterized by uncertainties and large externalities, often extending their effects beyond national borders. To be effective, in many cases interventions need to be implemented at the regional or even global level, requiring closer policy coordination and cooperation between countries than has been experienced in the past.
- 2.36 The challenges are also vast because our understanding of the underlying physical processes and their relationship to economic behavior is incomplete. For example, policymakers need to identify more precisely the costs and benefits of energy derived from different bio-fuels. To do so, they need to measure accurately the net impact on carbon emissions and energy consumption of various forms of bio-fuel production; this is very much work-in-progress. Developing the right mix of regulations and market incentives to save on energy and diversify its sources is also work-in-progress, as is the development of the institutions required to sustain efficient markets for trading in pollution permits. The world as a whole also needs to comprehend better the environmental implications of deforestation

- and depletion of aquifers, for example, and the appropriate public policies to deal with these phenomena. Understanding the implications of changes in the temperature of the globe is also central for the many countries that are strongly exposed to natural disasters like floods, droughts, and hurricanes.
- 2.37 Timely and effective responses to these challenges are critical for the region. As the development bank with the largest lending portfolio in the region, the IDB needs to have strong presence in the area of environmental protection, sustainable energy, and climate change, helping countries to understand these phenomena, to design the right policies, and to enhance their institutional capability to implement them. To be able to do so, in the past few years the IDB has been strengthening its expertise and expanding its capabilities in this sector. It has launched and is expanding its Sustainable Energy and Climate Change Initiative (SECCI) (GN-2435-1). It is also establishing new coordinating mechanisms with other multilateral agencies to tap ideas and sources of finance for projects in energy efficiency and environmental protection, as part of a global response to a truly global challenge.
- 2.38 The changing context of Latin America and the Caribbean generates challenges that go beyond the five institutional priorities discussed above. Notable improvements have occurred over the years in the quality of human resources engaged in policy making, whether in government offices, think tanks, or academic institutions. Progressively more policymakers have advanced degrees in various disciplines, combined at times with substantial international experience. Thus, the Bank's contribution to the region depends not only on choosing the right sector priorities, but also on the quality of work that underpins Bank operations in those sectors; quality that must be measured against countries' increasing expectations, on one hand, and the work performed by competing development institutions, on the other.
- 2.39 Strengthening the Bank's analytical capabilities therefore goes hand-in-hand with identifying priority sectors for Bank operations. The Bank must strive, in particular, to become a reference point in policy debates and analysis on the five priority areas discussed above. This does not imply that a set of predefined policy suggestions must be developed and advanced for all five areas for all countries for all times. On the contrary, the Bank needs to be open to a variety of approaches to solving development problems rather than being locked into rigidly held viewpoints. The commitment is not to find magic bullets, but to seek evidence-based and analysis-driven discussion of alternatives and options. This commitment implies that sector policies must be seen as statements of broad principles and objectives, not detailed prescriptions.

E. Adapting the Bank's Business Model to Meet Its Institutional Priorities

- 2.40 The Realignment was key in the construction of the new organizational model, transforming the Bank's organizational structure and its performance levers. Several distinctive features of this new structure should be underscored. First, it

increases country focus and the importance of the functions needed to build country relations. Second, it deepens and increases the Bank's sector expertise, increasing the value-added and impact of the Bank's program. Third, it establishes mechanisms for business units to work as teams. Fourth, it places greater emphasis on performance measurement and risk identification and management at an early stage in the development of country programs. It is expected that the Bank will not only be more responsive to country needs, but will do so with a greater pool of expertise.

- 2.41 The proposal for a New Operational Framework aims to equip the Bank with a strategic direction for the upcoming years that complements the Realignment, and provides it with the tools to fully serve the development needs of the region. Increasing the Bank's relevance hinges on: (a) helping borrowing member countries face the social and economic challenges resulting from the current global financial market crisis; b) playing a countercyclical role during periods of financial stress; (c) offering financial and knowledge and capacity-building products that fill gaps in finance, risk management, and knowledge demanded by our clients; (d) working with a broader set of development actors, including sub-national entities and the private sector; (e) focusing on development results; and (f) reducing clients' transaction costs of doing business with the Bank.
- 2.42 This document does not address the reforms that will need to be introduced to the IDB's concessional funds (Fund for Special Operations, FSO) in order to position the Bank to better serve all its clients. Management intends to present options regarding the financial sustainability of the FSO to the Board of Executive Directors and, subsequently, to the Board of Governors in the first half of 2009. It will also present an initial two-year review of implementation of the debt sustainability framework and performance-based allocation, which were requested by the Governors in 2007.

III. AN INTEGRATED INITIATIVE TO STRENGTHEN DEVELOPMENT EFFECTIVENESS

- 3.1 This chapter summarizes Management's proposal on the Bank's Development Effectiveness Framework (DEF) (GN-2489) approved by the Board of Directors in October 2008. The DEF aims to provide the Bank with the tools needed to continuously assess performance, learn from past experience, and ultimately lead to the increased effectiveness of all its interventions. These tools are essential to prioritize Bank action and allocate its resources toward those interventions with maximum development impact. This becomes particularly critical, in light of the global financial crisis, and the anticipation that its effect on the region will generate greater demand for Bank resources than it can provide. Finally, the DEF represents a firm commitment to remedy existing deficiencies and to generate a new agenda for development effectiveness that is consistent with international standards and fully satisfactory to IDB member countries.

A. Rationale for Change

- 3.2 During the past decade, the concept of development effectiveness has progressively gained relevance in development institutions and the countries of the region. It encompasses at least three broad concerns: (a) the need to align available resources with country priorities, including the Millennium Development Goals; (b) the need to improve the impact of development interventions in line with a results-based approach that is fully integrated into the management cycle; and (c) the need to legitimize the use of resources for development interventions by accounting for the results achieved.

1. The International Community and Good Practice Standards

- 3.3 Development effectiveness is an important part of the agenda of the international community. With the 2005 Paris Declaration on Aid Effectiveness, the international development community provided “a practical, action-oriented roadmap with specific targets to be met by 2010” in five areas (country ownership, alignment of agendas, harmonization, management for results, and mutual accountability).¹³ The harmonization efforts carried out by the multilateral development banks have also been noteworthy. Through the Evaluation Cooperation Group, the multilateral development banks (MDBs) have formulated and reached agreement on common standards and good practices for evaluation for private sector investment operations; for public sector operations, with an addendum for policy based lending; and for Country Strategies. Finally, the MDBs have also set in motion several initiatives to support management for results, such as the Common Performance Assessment System (COMPAS), which establishes a uniform framework for reporting on efforts to improve MDB performance, and draws heavily on the Good Practice Standards (GPS) of the Evaluation Cooperation Group (ECG).

2. The IDB Group and Development Effectiveness

- 3.4 The Bank has a long way to go with regard to development effectiveness. As stated in OVE’s evaluation of the 2005-2008 NLF, “the Bank’s current systems, procedures, and guidelines have not yet built the capacities needed to demonstrate development effectiveness.” The move to an evidence-based, results focus in all areas of the Bank has taken on added urgency. As a growing number of Bank clients become more technically sophisticated, and their ability to formulate, execute, and sustain good development policies strengthens, their focus on development effectiveness has become more pronounced.
- 3.5 The Bank’s progress has been varied in implementing MDB-GPS for determining the effectiveness of its interventions. ECG-GPS have been implemented in non-sovereign guaranteed operations (NSG) over the past seven years. The IIC

¹³ See *Synthesis Report on the First Phase of the Evaluation of the Implementation of the Paris Declaration*, Copenhagen, July 2008, p. iv.

pioneered the application of ECG-GPS by implementing a Development Effectiveness Framework in 2001. It has already completed five cycles of evaluation and validation by OVE. The MIF implemented the Expanded Supervision Report (ESR) as its self-evaluation tool in 2008, which OVE has stated is compliant with the ECG-GPS. SCF adopted the standards in 2006 and, after a first self-evaluation exercise and a review by OVE in 2007, undertook an overhaul of its practices in 2008 in order to harmonize with the IIC. The objective was to provide a more systemic approach to reporting on expected development outcomes and additionality, and apply a rigorous project screening criteria.

- 3.6 Evaluations conducted by OVE of Bank sovereign guarantee operations (SGO) over the past five years have found that the incentive structure, validation methods with little evidence-based information, and lack of common criteria to assess and evaluate programs (non-compliance with MDB-ECG standards) are at the heart of the Bank's inability to demonstrate the development results of its operations. The weakness of the evaluation framework generates discrepancies between the self-assessments, done on the probability of achieving development results, and the actual results of SNG operations at completion.
- 3.7 The increased focus on effectiveness has expanded from assessing development results at the project level to the country level through the use of country-level outcomes in the Bank's Country Strategies. OVE's evaluations, however, have found that Country Strategies: do not clearly establish the consistency of the Bank's proposed program to the country's development goals; do not provide an evidence-based assessment of the achievement of the expected results; and are not built on lessons from prior interventions.

B. Proposal for Increasing the Development Effectiveness of Bank Products

- 3.8 The first step to address the needs outlined above is to ensure that Bank interventions can be evaluated to know if the right things are being done rightly. This is known as "evaluability," which the Development Assistance Committee (DAC) of the OECD defines as the "extent to which an activity or a program can be evaluated in a reliable and credible fashion." Evaluability relies on (a) a set of standards that form the frame of reference for designing an intervention; (b) a basic set of dimensions to be reported on at different levels (corporate, country, project, and non-financial product) and that are translated into indicators; (c) adequate, timely, and reliable monitoring systems and instruments; and (d) the capacity and right incentives for Management and staff to report and use the information produced.
- 3.9 The DEF represents Management's strategic decision to increase the effectiveness of all Bank activities by: (a) setting clear standards and metrics for the evaluation of all development interventions (sovereign and non-sovereign guaranteed operations, country and regional strategies, and knowledge and capacity-building products (KCP); (b) providing clear guidance to staff about analytical

requirements for meeting these standards; (c) aligning governance structures to comply with established good practice standards; (d) creating a results framework and incorporating it into the Corporate Performance Framework to monitor progress through key development effectiveness indicators; and (e) devising an action plan for the successful implementation of this framework.

- 3.10 The proposed DEF architecture deals with the three categories included in the standards: governance, metrics, and reporting. It also aligns the instruments for monitoring and the incentives necessary to ensure compliance. It presents a comprehensive system that encompasses all Bank interventions: sovereign guaranteed operations, non-sovereign guaranteed operations, country and regional strategies, and knowledge and capacity-building products. The following sections will describe the governance structure proposed (process), the alignment of Bank instruments of evaluation to ECG-GPS, and the reporting mechanisms for tracking progress in the achievement of the DEF's objectives.

1. Governance

- 3.11 Aligning governance structures to standards requires reviewing the responsibilities for Vice-Presidencies (VPs) in charge of self-evaluation, the responsibilities of the strategic core departments, and those of OVE and the Board of Executive Directors.
- 3.12 VPs are responsible for ensuring that interventions are designed and executed according to the applicable good practice standards, and that self-evaluations are conducted in a timely manner. To achieve the latter, VPs establish a delivery schedule for completion reports, which are the reporting tool for self-evaluations of interventions. The Strategic Planning and Development Effectiveness Department (SPD) is part of the self-evaluation system of the Bank. Its role is to support the self-evaluation function across interventions, including the development and application of evaluation guidelines and standards, and the identification of problems encountered. VPs may draw on SPD for technical support in ensuring that completion reports are delivered in accordance with evaluation guidelines.
- 3.13 The Bank's governance structure with respect to independent evaluation is aligned with GPS. OVE transmits its findings to the President of the IDB and its Board without any clearance from Management. The Board oversees OVE's work through an evaluation oversight committee, which for the IDB is the Board's Policy and Evaluation Committee.

2. Metric and Instruments

- 3.14 To increase the Bank's capacity to demonstrate development results based on empirical evidence, Management will adopt the MDB-ECG evaluation standards for all instruments, including: (a) evaluability instruments that measure whether the evaluation and results proposed for a product are robust enough to be

demonstrable at completion of the intervention being assessed; (b) monitoring indicators, which as a set facilitate management of product implementation to ensure that activities and outputs are generated in the expected time frame and on budget; and (c) evaluation instruments, which define clear and objective metrics, analytics, and processes for reporting results that can be validated independently.

- 3.15 According to the ECG's Good Practice Standards for specific products, the DEF will incorporate measures for the core and optional standards for evaluation. Core standards are those that establish key principles for evaluation and are necessary to permit comparability of results across MDBs. Optional GPS are not required for comparability but they contribute to increase accountability within a particular MDB. GPS are defined for **process** (conduct of evaluation), **metrics**, and **dissemination** of evaluation products. The DEF streamlines the instruments that measure performance from appraisal to evaluation by introducing a "development effectiveness matrix" (DEM) for each type of intervention that addresses the core and optional standards. The DEM instrument provides the basis to determine the evaluability of an intervention, and supports the monitoring of indicators and the metrics needed to evaluate results.

3. Reporting

- 3.16 At the project level, reporting on results will be done through reports that draw on the DEM instrument. For SGO, the DEM will include development performance areas that incorporate ECG-GPS, other best practices among public sector windows of other MDBs, and the Bank's strategic areas (i.e., the IDB's 8th mandates, sector specific initiatives). For NSG/private sector operations, the DEM consists of five performance areas under development outcome and two performance areas under additionality, with indicators that are compliant with ECG-GPS standards. For Country Strategies, a "Country Results Matrix" will establish the Bank's intervention logic and links to country priorities and outcomes. It will be updated periodically to track implementation progress, and to report on results achieved at the country level. Finally, all KCPs will include a clear statement of expected development effects, which will be presented in a DEM, linked to a given program.
- 3.17 At the corporate level, the Corporate Performance Framework (CPF) will define the Bank's key institutional objectives and provide specific indicators that allow the Board and the public to track progress toward established goals. The CPF is the monitoring instrument at the corporate level and sets clear targets for improving aggregate performance. The instruments developed in the DEF establish precise development results indicators for the first dimension of the CPF related to country focus and development outcomes.

- 3.18 Finally, the Development Effectiveness Overview will be the reporting instrument that will provide the Board of Executive Directors with the overall assessment of compliance with the standards, and will analyze the outcomes achieved at a more aggregate level. It will serve as the vehicle for the Bank to report on the results achieved through its interventions, present the lessons learned in the process of self-evaluation, and provide an assessment of the Bank's contribution to the development goals of the region.

IV. PROVIDE HIGH-VALUE PRODUCTS ALIGNED WITH CLIENT NEEDS

A. Financial Instruments

- 4.1 In this section Management presents a road-map of changes it plans to propose to the Board of Executive Directors, over the course of 2009 and beyond. These changes intend to phase-out financial instruments with non-market-standard features and to replace them with a broad selection of market-standard instruments that will enable borrowers to improve management of their liabilities, reducing risks to themselves and the Bank.

1. Rationale for Change

- 4.2 The IDB and the region are facing a global liquidity crisis. This underscores the need for the Bank to offer its clients more standard instruments to allow borrowers, and consequently the Bank, to better manage their respective financial risks.
- 4.3 For much of its history, the Bank has offered financial products which have been considered safe and stable for borrowers and the Bank to manage. As financial markets developed and hedging instruments became a standard way of managing financial risk, the IDB's financial products--with their embedded currency and/or interest rate risk stabilizing mechanisms--became riskier for the Bank and its borrowers since their non-market standard features made them difficult or impossible for borrowers to hedge.
- 4.4 As more sophisticated borrowers adopted new risk management techniques and hedged their liability risks, they were not able to follow suit with IDB loans. This became riskier for the IDB, because it increased the risk of loan prepayment and forced the Bank to transfer the associated unwinding costs to other borrowers, thus compounding the risk to all borrowers. By eliminating the embedded stabilization mechanisms from the Bank's products, the Bank would reduce the complexity of its instruments and make them more transparent, thus reducing risk while enhancing the value of its products.
- 4.5 In this section, we offer an overarching vision of how the Bank could more fully align its financial products with evolving market standards, so that these products can be more easily managed within the broader debt portfolio of each borrower. These products would allow borrowers to better manage their liabilities and consequently reduce the probability of loan prepayment to the Bank. In addition, even if borrowers prepay the Bank, the associated unwinding costs would be minimal and would be passed on to that particular borrower, rather than all Bank borrowers, as is currently the case. Furthermore, more predictability in disbursements would allow the Bank to manage its own liquidity more efficiently. These changes should and could be done in a way that does not expose borrowers with less market access and less risk management sophistication to additional risk.

4.6 Given that this document is being prepared during a period of extreme market volatility and stress in the global financial system, it is necessary to highlight that the changes proposed here do not expose the Bank or its borrowers to more risk. Instead it offers them a better way to manage the risks they already take. The Bank and its borrowers can manage and hedge liquidity and market risk better when disbursements are more predictable and when all or most of their assets and liabilities are exposed to market risk in a standardized form.

4.7 Although the Bank has made much progress in recent years aligning its mix of financial instruments with evolving international market standards, it still offers or is exposed to loans and guarantees with non-market-standard financial terms, such as:

- Currency Pooling System (CPS) loans in which principal is denominated in a changeable unit of account, based on bonds in four currencies—U.S. dollars (USD), euros (EUR), Japanese yen (JPY), and Swiss francs (CHF).
- Single Currency Facility (SCF) Adjustable and CPS lending in which interest charges are based on the changeable mix of fixed and floating-rate bonds the Bank has used to fund a loan pool.
- Sovereign guarantee loans with variable lending spreads to partially cover loan origination, execution, and servicing costs, at terms set by the Board semiannually.
- Facilities without fixed disbursement schedules, which carry a credit charge on undisbursed balances and whose disbursement may extend from several years to short notice.
- Loan products with inflexible amortization schedules, set without regard to project cash flows.
- SCF Adjustable and CPS loans that give the borrower a free option to prepay at par, which when exercised may raise costs to other borrowers in the pool or in other pools.

4.8 This patchwork of non-market-standard financial terms emerged mostly from the IDB's efforts as a cooperative institution to reconcile two responsibilities:

- Maintaining Bank solvency by avoiding market risk, particularly in currency and interest rates, which meant those risks must be exactly matched or pooled, in effect passing them onto members (albeit nontransparently).
- Lending to borrowing members that (a) lacked local markets or had underdeveloped markets that were too small to handle borrower needs;

(b) lacked good access to international capital markets, at least on terms obtainable by the Bank; or (c) lacked the ability to manage their market risks well.

- 4.9 The nature of the borrowers described above has changed dramatically since the Bank's establishment. Some sovereign borrowers still lack access to credit markets or adequate means to manage liability risk. Others have investment grade credit ratings, local markets with fixed-rate bonds maturing out to 20 or 30 years, and sophisticated risk management capabilities. The demand for USD loans by these larger, sophisticated borrowers has in some cases diminished, not because of cost, but because the Bank's USD loans cannot compete with their local markets, especially in times of abundant capital inflows. The Bank needs to find ways to make its essential financial product – credit – more valuable to these clients.
- 4.10 The Bank needs to continue updating its product mix to attract financially more developed borrowers while ensuring that the demands of those less far along can be met. The present rigidity reduces the Bank's ability to meet borrower needs. For instance, one borrower may wish to explore potential exit strategies from the SCF Adjustable rate pool into another IDB product, while another is interested in prepaying these loans entirely. The structure of today's products generates a lack of price transparency for both, creating difficulty in hedging exposures. In addition, borrowers who want to borrow in a mix of currencies, or who want stability in interest expense from a mix of fixed and floating rate debt, can create it themselves, making these adjustable rate pools unnecessary. For less sophisticated borrowers, the Bank might design a standard mix that balances the risks much like the SCF Adjustable currently does (but without its problems).
- 4.11 Despite the work to be done, the Bank has made significant progress toward offering market-standard instruments that should not be overlooked:
- In 1996, the SCF Adjustable was introduced as an alternative to CPS. Albeit still part of a managed pool, these single currency loans were offered in USD, EUR, JPY, or CHF with a changeable mixture of fixed and floating rates. Outstanding SCF Adjustable loans are currently about US\$22 billion and are denominated primarily in U.S. dollars.
 - In 2003, the CPS facility was closed to new approvals, although disbursements on already approved loans continue in small amounts. Outstanding CPS loans currently total about US\$14 billion.
 - In 2003, SCF Libor loans were introduced. Like the SCF Adjustable, these are single currency loans offered in USD, EUR, JPY, or CHF, but with costs based on the London Interbank Offered Rate (Libor). They are still pooled, and the Bank's variable sub-Libor funding spread is passed on to borrowers. Borrowers also are charged the variable lending spread approved periodically by the Board. De facto these loans carry interest charges at Libor plus or minus a variable spread, still making their spreads

unpredictable. Outstanding SCF Libor loans are currently US\$9 billion, and are mostly USD denominated.

- In 2005, the local currency facility (LCF) was introduced. In 2008, the Board approved an enhanced version of this facility that eliminated many of its former limitations. LCF borrowers may now convert existing SCF loans to local currency, however, not the reverse. In addition, amortization schedules became more flexible. The LCF represents a major advance in the Bank's offerings and has features that could be applied to the SCF (for example, flexible amortization schedules). Its main limitation is the Bank's ability to hedge. LCF outstandings currently total about US\$280 million.
- In 2006 the partial credit guarantee product for private sector operations was revamped to make it more market friendly, producing greater demand for that product from NSG clients.
- In mid-2007, a fixed-rate conversion option was offered for SCF Libor loans whereby the Libor level and the estimated average long-term sub-Libor cost of borrowing are fixed. The Board-set lending charge, however, is still passed down to the borrower, making these loans fixed-rate plus a variable spread (thus, still unpredictable). To date, about US\$231 million in loans have been converted to a fixed-rate base.
- In 2005, as part of the local currency facility, the Bank's local currency swap product was introduced. Although swaps need not be matched to a specific loan, the notional outstanding is limited to the outstanding of all the borrower's loans (projected over their combined payment schedule). The Bank, therefore, does not yet offer a purely stand-alone swap product. The Bank has recently entered into an ISDA Master Agreement with one sovereign borrower, and is currently negotiating ISDA Master Agreements with two other sovereign borrowers.
- Lastly, NSG lending is already more market standard than SG lending. NSG lending is at fixed spread over Libor with significant flexibility on amortization schedules. Given the Bank's limited ability to match funds, NSG borrowers are the primary clients for LCF loans.

4.12 Learning from the progress to date, responding to the increasingly sophisticated needs of some major Bank borrowers, and considering the Bank's need to manage its own market risks prudently, a vision for financial products is presented in the following box. The sequence of specific initiatives to implement it is discussed in Annex 2.

A “Menu” Approach to the Bank’s Financial Offerings

The Bank and the borrower would construct the financial payment terms for a new and/or existing instrument by selecting features from a menu of choices. Tranching would allow mixed features in selected choices.

Choice of Instrument Type: Applicable to:

1. New Instrument (e.g., new loan)
2. Existing Instrument Conversion (e.g., loan conversion)
3. Swap Instruments (e.g., from floating to fixed interest rate and/or between approved currencies)

Features

1. Programmed disbursement schedule:
Aimed at minimizing/eliminating the commitment fee charged to the borrower on a revenue neutral basis
2. Flexible amortization/payment schedule
3. Selection of denomination of currency:
 - a. Nominal currency (e.g., USD, EUR, MXN, BRL, etc.)
 - b. Real (inflation-adjusted) currency
4. Selection of payment currency:
USD, EUR, MXN, BRL, etc. (may be different from that of denomination)
5. Pricing options
Calculated as base rate plus spread and charged on outstanding loan balance
 - a. Base rate is:
 - ✓ Fixed constant (e.g., 5.0 percent)
 - ✓ Floating index (e.g., USD Libor)
 - b. Spread is:
 - ✓ Zero (i.e., included in fixed base rate)
 - ✓ Fixed constant over floating index (e.g., 5bp)
 - ✓ Variable over fixed constant or floating index:
Current cost-of-borrowing spread (e.g. –20bps) plus variable credit spread (e.g. +25bps)
6. Embedded optionality (longer-term priority):
Additional charge based on market cost of hedging for the Bank
 - a. Interest rate caps/floors
 - b. Right to prepay at par
7. Tranching
Breaking a loan into multiple tranches would allow borrowers to create custom pools with the desired features.

2. Foundation and Architecture of the Bank's New Financial Product Framework

- 4.13 The preceding box summarizes what the fully implemented vision for financial instruments would look like, dealing with all the issues and problems noted under "Rationale for Change."
- 4.14 The foundation of the Bank's new vision calls for integration and expansion, within policy and risk management guidelines, of the existing Libor-based SCF and the Local Currency Facility. The goal is the creation of a unified lending facility that allows borrowers to select from a menu of features to tailor the terms of their loans together with embedded optionalities.
- 4.15 Rather than being confined to newly originated loans, this vision also could apply to outstanding loans by offering borrowers the option to convert from their current instrument. This would be particularly useful for CPS and SCF Adjustable products.
- 4.16 Although universally available for all Bank borrowers, the new menu of financial offerings will continue to apply cooperative pricing principles to sovereign guarantee financing and market based pricing to non-sovereign guarantee financing. Furthermore, the standardized financial instrument for SG and NSG borrowers will probably differ and/or be restricted by market availability, transaction creditworthiness, compliance with Bank policies, and the Bank's ability to implement a specific loan structure when the borrower demands it.

B. Knowledge and Capacity-Building Products (KCP)

- 4.17 Management proposes to make knowledge and capacity-building products (KCP), which contribute to the intellectual and/or institutional capacity of the Latin American and Caribbean countries, a core business of the Bank, equivalent in importance to sovereign and non-sovereign guaranteed lending. To attain this the Bank should substantially strengthen its ability to produce KCP that are tailored to client needs, and to provide them in an effective, reliable, and sustainable manner.
- 4.18 Improving the quality and increasing the quantity of the Bank's work on KCP is essential to ensure the Bank's relevance as a key player in fostering the economic and social development of the countries in Latin America and the Caribbean. Even in times of crisis borrowing member countries want the Bank's ideas and best practice on how to address their development challenges in the most economic way. Moreover, by strengthening its work in KCP, the Bank would be fulfilling its corporate mandate, which 50 years ago envisaged technical assistance as a substantial component of its work.

1. Rationale for Change

- 4.19 During the early years of the IDB's history, the countries' development financing needs made lending a priority. Knowledge generation and capacity-building activities not only had a lower priority, but also were mostly envisaged as inputs to the preparation of loans. As the quality of policies and institutions was recognized as a key determinant of development, and Latin American and Caribbean countries improved their access to national and international capital markets, knowledge and capacity-building have attracted more attention.
- 4.20 With the organizational changes and changing priorities of the 1990s, a number of knowledge and capacity-building activities began to take shape as true Bank products with a value of their own. These included economic and social research, support for regional public goods, external training, regional policy dialogues, technical assistance, support for the development of national systems, seminars, and policy advice to governments.
- 4.21 The demand for KCP from the region led to growing institutional mandates to improve the Bank's work in this area. These mandates converged around the idea stated in the NLF 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 [non-financial products] activities becomes critical.*" Thus, the ability of the Bank to be more than a bank will increasingly depend on its ability to do considerably more than lending.
- 4.22 Evaluations conducted over the years to assess the development effectiveness of the various components of KCP have been critical of the ability of the Bank to guide, coordinate, and manage them.¹⁴ These assessments were summarized in OVE's evaluation of the 2005-2008 NLF: "*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.*"¹⁵
- 4.23 This dispersion of efforts seems related to the fact that KCP have been driven more from the input (financing) side rather than from the output (response to regional needs) side. Moreover, the piecemeal approach taken by the Bank in the planning, execution, and development of funding and operational vehicles for KCP has resulted in the inability of Management and the Board to have a comprehensive view of the extent, direction, cost, and, most importantly, results of the Bank's work in this area."¹⁶

¹⁴ Evaluations were of Technical Assistance (TA), Donor Trust Fund (DTF) activities, studies conducted by the Bank, Regional Policy Dialogues, and economic "encerronas."

¹⁵ Document RE-342-1, para.4.59.

¹⁶ See Document RE-342-1, para.4.56.

- 4.24 Since the 2005-2008 NLF, the Bank has taken some significant steps to improve the quantity and quality of KCP. These include the new organizational structure generated by the Realignment—particularly the merging of knowledge generation and operations in sector departments to optimize cross-fertilization—as well as changes to the policies on technical cooperation and learning.¹⁷ To consolidate these developments, the Bank now needs to recognize KCP as one of its core businesses. Consequently, the Bank should develop a comprehensive platform for KCP development, which includes adapting their funding, operational, and accountability arrangements.
- 4.25 The capacity of the Bank to consolidate KCP as a major business will define to a large extent its ability to remain a relevant and trusted partner of the countries in the region. It will also provide the Bank a fresh opportunity to respond to a historical mandate as well as to more recent commitments, like those made with the Governors in the NLF. KCP are crucial not only to enable the Bank to serve effectively those borrowing member countries that reduce their reliance on Bank financing, due to increased access to domestic and international capital markets, but also to address major bottlenecks to sustainable development in the whole region, particularly in poorer and smaller countries.
- 4.26 Deeper knowledge, better policymaking, and stronger institutions may also open the opportunity for financing in new areas, raise the chance of success of Bank-funded projects, broaden the portfolio of Bank clients and ensure a continued engagement between the Bank and its clients in times of financial turmoil¹⁸.

2. A New Platform for Knowledge and Capacity-Building

- 4.27 Management will submit a full proposal to the Board laying out a comprehensive platform for planning, managing, monitoring, evaluating, and sustainably financing KCP, placing them at the strategic core of the Bank's new business model and securing their relevance to the Bank's clients. This platform is summarized below and includes: (a) a new coherent taxonomy; (b) stable and integrated funding; and (c) a common operational and accountability framework.

a) A coherent taxonomy

- 4.28 KCP are defined on the basis of four concurrent conditions:
- They directly or indirectly increase the intellectual and institutional capital of Latin American and Caribbean member countries.

¹⁷ These include the new Technical Cooperation (TC) Framework (GN-2429-2), the TC Policy (GN-2470-2), and the new Knowledge and Learning Strategy (GN-2479).

¹⁸ In times of financial distress, the attention of governments tends to shift toward securing access to liquidity and away from loans that finance interventions with greater value added. Consequently, the ability of the Bank to “unpack” financial and knowledge components into separate products—lending and non-lending—may be crucial to secure continuity of the latter.

- They are stand-alone, that is, they do not depend on being part of a loan to contribute to the economic and social development of the country or region.
 - They draw down the Bank's exhaustible resources, that is, its OC net income, reserves, and Donor Trust Funds.
 - They are managed and funded as products, identifying their main objectives and means to attain them.
- 4.29 Some products that fulfill these conditions include lessons learned and best practice papers, capacity-building programs like PRODEV, conferences and seminars (external), economic assessment reports, economic consultation missions, policy research, analytical papers, and external training, among others.
- 4.30 This definition involves two major departures from the concept of non-financial products (NFP) traditionally used in the Bank. On the one hand, it excludes NFP whose effects are mostly limited to the Bank as well as those whose impact on countries is embodied in the preparation of a loan or support to loan execution. On the other hand, it includes products that are funded from sources other than the administrative budget and covers TCs currently funded from FSO net income, Donor Trust Funds, off-budget special programs funded from OC net income, and the MIF.
- 4.31 According to this definition, it is estimated that the Bank invested between \$117 and \$127 million in KCP in 2007. This figure may reach more than \$130 million in 2008.¹⁹ Funding for these investments comes from four different sources: Ordinary Capital (Administrative Budget and OC funds for Special Programs and initiatives); FSO net income; Donor Trust Funds (DTF); and the MIF. Funds are channeled through the work program of the Research Department, stand-alone administrative budget funds in a dozen different departments, non-financial products in country operations, and technical cooperation projects financed by 47 donor trust funds, 12 budget initiatives, 11 off-budget special programs, and the MIF.

b) Funding managed in an integrated system

- 4.32 For KCP to become a major business of the Bank, its funding base should be strengthened, aiming at increasing the volume, stability, and predictability of resources allocated to this end. This would allow the Bank to provide a more effective response to country needs and to set its strategies and policies over a more extended horizon than today. For our clients, this would turn the Bank into a more reliable partner to manage knowledge and build up institutions.
- 4.33 The Bank may increase funding for KCP by improving its management of OC capital and reserves, mobilizing donors' contributions, and generating fee-based

¹⁹ The range results from personnel costs involved in the delivery of OC-funded KCP.

services. As nearly 25 percent of current funding from KCP comes from OC net income –through the administrative budget and special programs—any improvement in the risk-adjusted returns on investment of the corresponding share of OC capital and reserves would generate additional resources to support KCP. Such improvement may require different investment policies, which in turn need to be supported by the new capital adequacy model that will be developed under the NOF. Donors’ support for KCP may also increase as a result of better management of their funds through the creation of thematic multi-donor trust funds, as envisaged in the new TC policy.

- 4.34 Furthermore, funding for KCP may be expanded by creating a fee-based technical assistance facility. This would allow the Bank to provide expert advice to countries that do not require financing but need external support in the analysis of current economic and social problems and in the formulation, execution, and evaluation of public policies. Given this objective, fee-based services should concentrate on direct responses to clients’ requirements, but may not be appropriate for KCP that have a more strategic and long-term focus.
- 4.35 Predictable and sustainable funding, however, may require additional efforts to overcome the effects of the current dispersion of funding sources and channels. Such efforts should be oriented toward unifying and simplifying KCP funding to the largest extent possible. As a step in this direction, all funds originating in OC net income will be consolidated into a single mechanism, bridging the current divide between administrative budget financing for stand-alone activities, initiatives, and special programs, and OC off-budget funding for special programs. Specifically, all OC-originated funding for KCP will be included in a single budget and reflected separately in the Bank’s financial statements. The consolidated OC-KCP budget will be approved by the Board separately from the Administrative Budget, and allocated to different broad KCP categories on the basis of a two-year rolling KCP program.
- 4.36 The establishment of this consolidated OC-KCP funding mechanism has a number of virtues. First it will unify the annual flow and resource allocation and operational arrangements of some 30 windows. Second, it will increase the transparency and accountability of the Bank’s work in providing KCP to the LAC region. Above all, the establishment of a unified OC-KCP funding mechanism will be a powerful signal that the Bank is making knowledge and capacity-building a relevant and permanent business.
- 4.37 Consolidation of OC funding for KCP will be a key step to integrate it with donor trust funds, FSO, and MIF under a common financial framework. Such a framework will include a common programmatic classification and a medium-term financial scope. Consistent with the proposal for sovereign guaranteed and non-sovereign guaranteed business lines, KCP should be managed under a two-year rolling program considering the main sources of funding and the main priorities for resource allocation. Multi-year, integrated financial planning should

help to smooth out expected changes in the contribution of different sources of KCP funding.

c) Part of a common operational and accountability framework

- 4.38 All KCP should be included under a common operational and accountability framework, independent of their source of financing. Such a framework should be separate from technical cooperation and non-financial products that operate as inputs into either financial operations or the corporate management of the Bank.²⁰
- 4.39 Operational and accountability arrangements for KCP should recognize that not all such products serve the same purposes and that there are relevant differences in the scope and rationale for them. If these differences are acknowledged, and operational procedures, resource allocation, institutional responsibilities, evaluation, and accountability mechanisms were arranged consistently, transparency would improve, incentives would be better aligned in the Bank, and assessment would be considerably easier.
- 4.40 In order to respond to the different purposes served by KCP, individual products would follow differentiated institutional streams adapted to their distinct objectives, motivations, and dynamics. This should be organized on the basis of four broad categories built on the basis of the scope and driving force of each group of KCP, namely, (a) short-term response to clients; (b) policy and institutional development in countries; (c) outreach and dissemination; and (d) strategic research and development.
- 4.41 The allocation of resources for KCP would be organized in three stages: categories, programs, and projects. Country and/or regional needs and focus, as well as Bank priorities, should be represented at each stage. The primary allocation of resources will be made by the Board at the level of the four KCP categories. Each category will be disaggregated into programs. Subsequent allocation of resources among programs will be done by Management under a structured process.
- 4.42 Institutional arrangements within Management should be aimed at ensuring strategic direction, quality assurance, and country focus to KCP. Strategic direction will be given by coordination at the level of the EVP, with representation of VPC, VPS, VPP, and SPD, either through a special purpose committee or the current Operational Policy Committee (OPC). In either case, VPS should be the executive secretariat to the committee on these issues, while GCM should play a key role in mobilizing resources and matching sources and uses of funds. The different categories of KCP will be under the responsibility of

²⁰ Corporate inputs should be funded entirely from the Bank's administrative budget, while operational inputs may continue being funded both from the administrative budget, FSO net income, and Donor Trust Funds. This would allow the inclusion of technical cooperation as part of the overall cost of programming and preparation of loans.

a specialized unit²¹. In any case, individual projects will be awarded financing under programs according to pre-established and transparent procedures where country focus and technical quality should be properly represented through VPs and VPC.

- 4.43 All KCP should have a clear statement of their objectives and expected development results, and be subject to evaluation. The results thereof would be used as feedback into the KCP decision-making process. Evaluations would be done at the aggregate, category, and program levels, on the basis of the objectives and expected development effects of each. Evaluation methodologies would be adapted to suit the features of different products, but country focus and technical quality should be assessed for all types of products. Information from the monitoring and evaluation of KCP should be provided to the Board regularly and used for accountability and feedback purposes.
- 4.44 The interplay among KCP, SG, and NSG lending will be facilitated by the fact that under the structure that emerged from the Realignment, the staff involved in the preparation of products under the three business areas will be essentially the same. This should be supported by adapting the selection, evaluation, and training of staff to ensure an adequate skills mix to manage the different types of products.
- 4.45 The country focus of KCP will be safeguarded by four features: (a) at least two categories of KCP (short-term response to clients, and policy and institutional development in countries) will be specifically aimed at responding directly to country demands; (b) the units responsible for these KCP categories will be country-based (COF in the case of short-term response to clients, and VPC in the case of policy and institutional development in countries); (c) country needs will be represented in the allocation of resources in the four categories through a process similar to the Country Studies Initiative; and (d) the performance of all KCP will be assessed on the basis of their ultimate impact in the countries and/or region.

²¹ For instance, KCP aimed at providing immediate response to clients should be under the primary responsibility of VPC and COFs, while strategic research should be under the responsibility of VPS and RES.

V. MOVE TO BUILD AND UTILIZE COUNTRY SYSTEMS

- 5.1 Management will propose mainstreaming the strengthening and use of country systems through a demand driven, gradual, and country-by-country approach. This chapter analyzes the reasons for increasing the Bank's reliance on country systems and summarizes the strategy to build up and use these systems, that will be submitted shortly to the Board of Executive Directors. The strategy proposes the systematic utilization of existing assessments²² to determine use and to provide capacity building interventions. This strategy sets the framework of Management's work on fiduciary reform and the risk management approach to projects.

A. Rationale for Change

- 5.2 Improved public sector management, efficient allocation and use of financial resources, and effective public service delivery are key goals of the Bank's member borrowing countries. Country systems refer to: strategic planning, public financial management, procurement, monitoring and evaluation, statistics, and environmental assessment (see Box 1).²³

Box 1: Country Systems: Definition and Scope

Strategic Planning comprises the long-term vision, medium-term programs, and public investment system (PIS) in a systematic process that defines and implements country priorities.

Public Financial Management Systems (PFM) comprises the legal framework, organizational structures, procedures and information systems used by country entities and statutory bodies for managing public finances. Such systems mainly include planning and budget management, treasury and country public debt, accounting and financial reporting, and internal and external control.

Procurement Systems are publicly administered and include all policies, procedures, instruments, controls, and organizational structures—both public and private—for the provision of goods, works, and services needed for a country's welfare and development. The basic principles that effective country procurement systems need to address are efficiency, transparency, economy, and due diligence.

Monitoring and Evaluation Systems are used to measure the quantity, quality, and targeting of the goods and services provided by the state, and the impact of results achieved. The value added of monitoring and evaluation systems for governments is having access to facts and evidence that support public decision making and results-based management.

Statistical Systems (SS) are broad systems with a clear center in the National Statistical Office (NSO). Their main objective is to generate information that improves the policy making process and supplies the data needed for monitoring and evaluation tools to work. In general, countries in the region have a statistical system that is defined by law but loosely organized in practice.

Environmental Assessment is a systematic process whereby the environmental and environmentally related social effects of a proposed intervention are analyzed. Environmental assessments can be done at the **project level**-- in which case they typically take the form of an environmental impact assessment (EIA) of a specific activity-- or at the **strategic level**-- in which case they apply mostly to the likely consequences of policies, plans, and programs.

²² In the specific case of Environmental Assessments, these will most likely require new and highly focused diagnostics for a particular sector, executing agency etc.

²³ It is important to note that not all systems will require the same strategic approach, were mainly decisions on use will relate to Financial Management, Procurement and Environmental Assessments; and capacity.

- 5.3 Over the last decade, Latin American and Caribbean countries significantly improved their country systems.²⁴ These improvements, however, have not generally resulted in increased reliance on country systems by MDBs or the donor community.²⁵ In the case of the IDB, Bank policies have not kept pace with developments in some country systems (e.g. *procurement*: framework contracts, e-GP, and reverse auctions; and *financial management*: the general adoption of integrated financial management systems), that are internationally recognized as best industry practices. This has created incompatibilities between country systems and existing Bank policies. Many borrowing countries have been investing heavily in strengthening their public management systems. Although the Bank has supported and encouraged these efforts, they have only partially been taken into account in the design and implementation of Bank financed programs.
- 5.4 Building up and using Country Systems has the potential to bring about benefits in several fronts. It enhances country ownership of its development agenda and facilitates alignment of Bank programs with country priorities, enhancing country-focus. It promotes the modernization of the country's public sector management and the reliability of its information systems, thereby setting an enabling environment for results-based management and increased development effectiveness. The adoption of Country Systems for Bank projects will generate reductions in transaction costs for the clients, as the need for applying policies and procedures other than their own will be reduced. This is of particular importance when countries face financial distress, as is currently the case. The tightening of available resources will require external financing to be more effective in delivering development results at lower costs. Finally, the availability of reliable socioeconomic data and the solid monitoring and evaluation systems that will result from this effort, will benefit the Bank in its country analysis and project supervision.
- 5.5 Increasing the use of country systems²⁶ is a core aspect of the international community's development effectiveness agenda. As part of the international commitments endorsed by the Bank (both in the Paris Declaration in 2005, and more recently in the Accra Agenda for Action (AAA)),²⁷ the increased use of these systems represents a concrete action toward building capacity to obtain positive and sustainable results from development interventions. The AAA calls for donors to: use country systems as the first option for managing aid programs; when not used provide a transparent justification; and support measures that lead to capacity building.

²⁴ For the purpose of this document, country systems will refer to strategic planning, public financial management, procurement, monitoring and evaluation, statistics, and environmental assessments at the national and sub-national levels, unless stated otherwise.

²⁵ See First Phase Evaluation of the Paris Declaration, 2008. The evaluation refers to public financial management and procurement systems, which were the focus of the Paris Declaration.

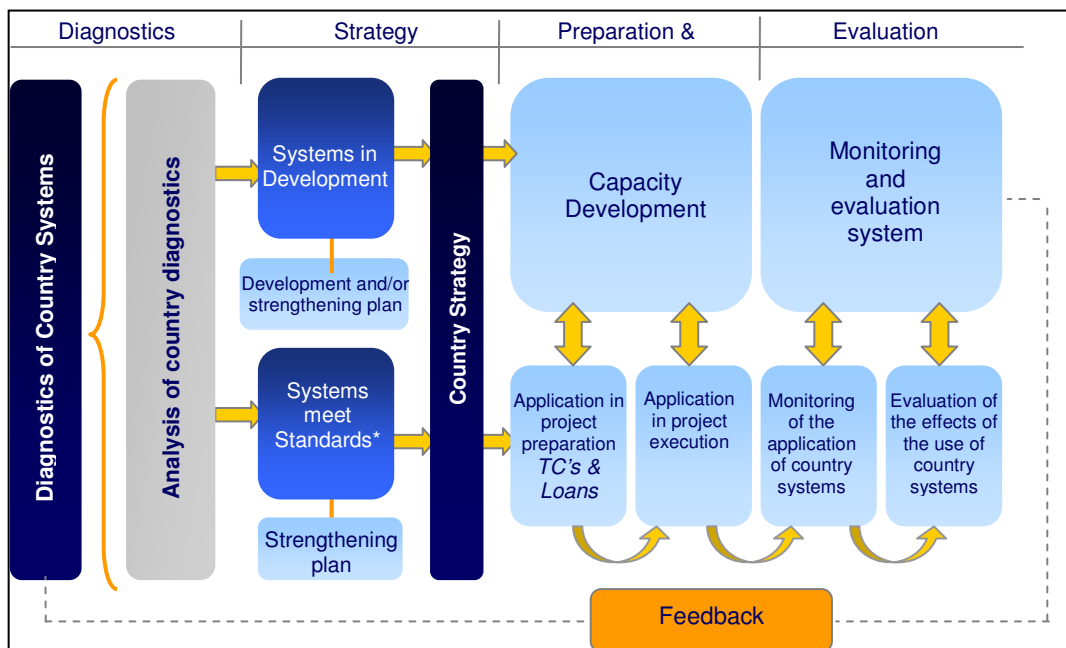
²⁶ Using country systems encompasses the reliance on a country's legal and institutional framework, procedures, controls, information systems, reporting regulations, monitoring and evaluation capacity for the design, execution, and reporting of development assistance.

²⁷ The AAA was endorsed by the Bank and more than 160 governments, international organizations, and private foundations at the Third High Level Forum on Aid Effectiveness on September 4, 2008 in Accra, Ghana.

- 5.6 OVEs evaluation of the New Lending Framework 2005-2008 (RE-342-1) places use of country systems as one of the necessary conditions for enhancing the country focus of Bank interventions. The evaluation found that country systems are treated in very general terms in the Country Strategies, with no strategic approach to increasing use. It pointed to three elements that are needed to move forward: (a) an institutional process for deciding on country system use that relies on the Country Strategy and programming process; (b) an explicit mandate to mainstream actions to support strengthening country systems through the Bank's operational work; and (c) expansion of the focus to incorporate investment planning and statistics, monitoring, and evaluation as key components for improving the capacity of countries to manage for results. In short, the Bank's decisions to build up and use country systems have often been taken in an ad-hoc manner, without a clear strategic approach or systematic follow-up and reporting.

B. Proposal for the Bank's Strategy toward Using Country Systems

- 5.7 The new approach for increasing the use of country systems calls for a comprehensive strategy that is consistent with the Bank's international commitments, and is country-driven and country-focused. It recognizes the importance of building capacity for more effective management of resources in member countries, and reducing the transaction costs imbedded in using Bank systems. The strategy aims to define criteria for determining the use of country systems and assist in defining a cohesive approach to strengthening public management capacity in borrowing countries. These criteria will be based on internationally accepted practices derived from existing internationally recognized diagnostic tools. Action plans for strengthening country systems will be designed with a targeted and country-tailored approach that will depend on the nature and development of each system.



- 5.8 Using the above mentioned tools will serve two purposes. First, it will ensure that the Bank's decisions on the use of country systems and the road map for strengthening them are based on the same body of evidence used by other donors and partners, thereby supporting a harmonized approach. Second, it will reduce the costs of diagnostic work for the Bank and its clients who have to manage multiple missions and assessments, frequently generating ambiguous or conflicting recommendations.
- 5.9 The analysis of country systems will be performed at the request of the client. The results of the analysis will be assessed by a technical panel²⁸ on the basis of objective, pre-established criteria. The panel will determine the extent to which the Bank will be able to rely on a given system. Any gaps identified would be addressed by a capacity building initiative, and the Bank would outline the benchmarks that would lead to increasing the use of those systems that do not meet minimum standards. In an effort to improve the effectiveness of public management the proposed capacity building measures would cover a broader scope than needed for Bank use.
- 5.10 Applying Bank systems in the context of weak capacity will not necessarily improve project execution or address deficient institutional arrangements. A capacity-building effort is clearly needed when Bank systems provide a more efficient mechanism for execution. To contribute to sustainable local capacity, the Bank's operational program should incorporate capacity-building measures aligned with the action plan agreed with the government to contribute to local capacity building. To support the improvement of country systems, the Bank will strengthen its capacity-building tools. This will include broadening PRODEV's sub-national window, establishing a sector line agency support window and creating a capacity development multi-donor trust fund, as proposed under the KCP initiative.
- 5.11 Monitoring and evaluation to review the implementation of capacity development action plans and the use of country systems will rely on the Development Effectiveness Matrix for Country Strategies (DEM). To adequately assess progress in use of country systems and the impact of the Bank's efforts to strengthen local capacity, the DEM will incorporate specific indicators to monitor progress in the implementation of the country action plans and the use of these systems. Management will track the number of projects using country systems and consultant-staffed PIUs.

²⁸ In addition to Bank technical staff, the panel may also include external experts.

VI. IMPROVING THE EFFICIENCY AND ANALYTICAL BASE FOR MANAGING THE BANK'S CAPITAL AND INCOME

- 6.1 Effective management of the Bank's capital and income is the fourth component of the New Operational Framework. Current financial market conditions underscore and highlight the importance of adhering to best practices in risk management. This includes building up the recently established Risk Management Group, and pursuing the existing initiatives to upgrade Bank risk management capabilities, such as the Credit Risk Classification System, investment portfolio analytics, asset and liability management and capital adequacy. To promote the objectives of the NOF, Management is enhancing the capital adequacy model, which aims to create the analytical base for allowing articulation of separate business lines and assessing the efficiency and impact of capital utilization by those business lines. An updated capital adequacy framework (policy and model) will enable the Bank to refine its operations and align itself with current best business practices.

A. Rationale for Change

- 6.2 The current framework was established in 2003 with the primary objective of capitalizing the Bank for its main risk, that is, the credit risk incurred in lending operations. The targeted capitalization level was designed to allow the Bank to sustain losses from a limited regional crisis²⁹ while maintaining its AAA rating, continuing full operations, and not using its callable capital.
- 6.3 Given the volume and growth prospects at that time, non-sovereign guaranteed lending was treated as a marginal product, measuring the embedded risks only in a simplified and conservative manner, which is not necessarily appropriate for the current expanded NSG lending volume. At the same time, capital requirements for the two types of lending currently are determined together, resulting in one ratio—the total-equity-to-loans ratio (TELR)—which commingles the exposures. As a single figure, this ratio does not facilitate risk assessment or capital utilization efficiency by business line as envisioned by this proposed Bank strategy.
- 6.4 In addition, since the current model was designed in 2003, best industry practices have evolved. The Basel II framework has established capital adequacy standards that, while not binding for the IDB, can function as a benchmark. These standards are not met by the Bank's present capital adequacy framework. In essence, it requires risk capital charges for credit and market risk of all asset classes, as well as a charge for operational risk. The Bank's policy includes only a charge for the credit risk of lending operations, excluding market risk on lending, market and credit risk on liquidity, and operational risk. The current

²⁹ Such a crisis is defined as one large borrower in default with the Bank plus borrowers equaling 25 percent of the Bank's loan portfolio in default with the financial markets.

instability in financial markets underscores the degree of convergence of all different risks and highlights the need to have the adequate analytical tool to address them.

- 6.5 Besides better assessment of the current underlying assumptions, revising the capital adequacy framework would support some priority areas in the Bank's strategy. Improved measurement of the Bank's risks in a comprehensive framework will enhance their management and provide flexibility in three areas: (a) it would refine the Bank's understanding of how much financing it can do with existing capital; (b) it would enable informed decision-making about growing one business line versus another by revealing risk and return trade-offs; and (c) it would accommodate new financial lending products more readily.

B. Proposed Capital Adequacy Framework

- 6.6 The proposed framework will be designed to facilitate the Bank's business strategy and to support the shareholders and Senior Management in making crucial decisions on capital allocation, volume, and desired returns of the Bank's business lines under the NOF, namely sovereign guaranteed lending, non-sovereign guaranteed lending, and knowledge and capacity-building products. This chapter describes the main elements of the proposed framework.

1. Comprehensive Approach to Risk Measurement

- 6.7 Following best business practices, the proposed capital adequacy framework will determine economic capital³⁰ requirements for the credit, market, and operational risk of the Bank's operations. In addition to these requirements and consistent with the noncyclical mandate of an MDB, it will continue to determine the level of capital that would allow the Bank to continue operating during a limited regional crisis while maintaining its AAA rating without the need of calling for capital from its shareholders.
- 6.8 The framework will consist of an improved model/system and a revised policy. During the implementation process, in addition to the setup for newly measured risks, a focus point will be to review and refine the input parameters for determining the credit risk requirements of lending operations, given the magnitude of the type of risk and its impact on the overall result. Parameters such as the adjustment of default probabilities for the Bank's preferred creditor status and the severity of losses once a default happens, as well as the internal rating process, will be included in the review, and applying improved methodologies will result in more-precise capital requirements.
- 6.9 Comprehensively measuring all risks and the relationships among them, combined with the ability to disaggregate the results and attribute them to specific

³⁰ Defined as the amount of capital that the Bank *should* have to be able to sustain losses from its operations with a given probability over a given time horizon. As an AAA-rated institution, the Bank should have sufficient capital to sustain losses that it could incur with 99.99 percent probability over a one-year period.

business lines/transactions, will build the necessary foundation for the other elements of the framework.

2. Capital Use by Business Line

- 6.10 The ability to disaggregate and to attribute capital requirements will help determine the extent and efficiency of the use of capital by the different business lines, that is, for sovereign and non-sovereign guaranteed lending, and knowledge and capacity-building products. By comparing the amount of equity³¹ assigned to specific business lines with their economic capital requirements, the efficiency of capital use can be assessed, and underused resources can be reassigned to support the Bank's other business lines for short-term or long-term use.
- 6.11 In addition, the amount of economic capital utilized by business lines, combined with their nominal returns, will allow the Bank to compute risk-adjusted returns by business line. Thus, the framework will facilitate strategic decisions related to the implications and effects of shifting capital among different uses.
- 6.12 Although the Bank's investment portfolios represent assets that require economic capital, they are not considered a business line by themselves. They are only a necessary component, or part of a necessary component, that provides support for "buffering" cash flows and creating income.

3. Volume of Bank Business Lines

- 6.13 The proposed capital adequacy framework will support risk attribution by business line, including knowledge and capacity-building products, and reveal the actual ratio of economic capital requirements among them. The framework will be able to provide requirements as a percentage of actual or desired volume for each business line. For example, if a business line had a 20 percent capital requirement, it would need \$200 million in equity to support each \$1 billion of credit extension.
- 6.14 Consequently, the proposed capital adequacy framework will enable the Bank to evaluate the trade-offs among economic capital requirements for all business lines and to consider this, together with the expected development impact, as a factor in weighing how much volume for each business line is desirable.

4. Lending Authority

- 6.15 The proposed revision of the Bank's capital adequacy framework will align it again with best business practices. The comprehensive approach combined with improved methodologies for deriving input parameters will result in more-precise measurements of the risk exposures that the Bank is facing. In this context, an improved capital adequacy framework would enhance the Bank's risk metrics for decision-making and it will be a valuable tool in determining how much of the

³¹ Defined as the amount of capital that the Bank *actually* has available to cover losses.

maximum lending limits set forth in Article III, Section 5 of the Charter (“Lending Authority”) may be used without affecting the Bank’s AAA credit rating.

5. Flexible Financial Instruments

- 6.16 The scope of the current capital adequacy model does not include market risk. Therefore, desirable offerings of potentially more developmental financial instruments have been limited because the Bank could not fully hedge the embedded risks.
- 6.17 By including market risk from lending operations in the economic capital requirements, the proposed capital adequacy framework would allow the Bank to use more flexible financial instruments without reducing financial prudence because the risks can be measured, reported, managed and priced.
- 6.18 Finally, this policy will define the general framework for capital adequacy while Management determines the appropriate methodologies and techniques for risk measurement. It is likely that amendments to other financial risk policies, such as the Bank’s Framework (Document GP120-2) and Liquidity Policy (Document FN-600), will be required. Such amendments would be submitted for approval by the Board of Executive Directors at the same time.

VII. ELIMINATE LENDING LIMITS BEYOND THE LENDING AUTHORITY AND ELIMINATE LENDING CATEGORY SUB-CEILINGS

- 7.1 In this section Management proposes that the Board of Governors authorize Management and the Board of Executive Directors to determine the volume and type of financing based on estimated demand and the Bank's capacity to support high impact interventions. At a time when the region and the Bank face a global financial crisis, the counter-cyclical role of the Bank— which is enhanced by the elimination of the limits on lending categories — becomes particularly important.

A. Rationale for Change

- 7.2 During the first 34 years, the Bank's lending envelope was successively committed and expanded through eight capital replenishments. From the last replenishment in 1994, until the first Lending Framework approved in 2002, the Bank operated without a fixed period lending envelope for OC. In the Lending Frameworks approved in 2002 and 2005, the Governors set a fixed-period lending envelope—for three years in 2002 for PBLs only, and for four years in 2005. More specifically, the current 2005-2008 Lending Framework sets the following limits:

- *Loan approval limits.* These set the maximum dollar volume of loan approvals (cumulatively over the planning horizon).
- *Lending category sub-ceilings.* These set the maximum volume of approvals for policy-based loans (PBLs) and investment loans. In addition, a revolving total limit was set on the Emergency Lending Facility (ELF).

- 7.3 Fixed-period lending envelopes and lending category sub-ceilings have not served the Bank well. Sub-ceilings can constrain the Bank's ability to address the needs of the region in a timely manner. The creation of the Liquidity Program for Growth Sustainability (LPGS), recently approved by the Board of Governors, illustrates this point. The \$6 billion limit for emergency lending, which is the source of funding for the LPGS, introduces an unwarranted tradeoff between the LPGS and the ELF; loans approved under the LPGS would reduce the amount available for emergency lending under the ELF.

- 7.4 OVE's evaluation of the 2005-2008 NLF highlighted several of the problems with fixed-period lending envelopes and lending sub-ceilings.³² In the following paragraphs we draw on OVE's analysis focusing on the evaluation's criticism of the sustainable lending level (SLL) and its use in setting loan approval limits.

³² See RE-342, "The Evaluation of the New Lending Framework: 2005-2008" (Chapter 1).

1. Loan Approval Limits

- 7.5 What had been the rationale for limiting total loan approvals over the planning horizon? The operations of the Bank are limited by the Charter, as well as by policies on borrowings and targets on capital ratios (see Box 2) approved by the Board of Executive Directors. These limitations apply to the outstanding loan balance (OLB) and net borrowing, and their main purpose is to preserve the financial soundness of the Bank -- that is, its AAA rating and favorable access to debt capital markets. Because loan approvals are the most important driver of the OLB, they must be carefully monitored to ensure that the sum of loan approvals does not put the Bank in a situation where further lending would need to be severely and unexpectedly curtailed or where other drastic actions would become necessary.

Box 2

The lending and borrowing limits of the Bank are established by the Charter and applicable Bank policy:

- **Charter Limitations.** The Charter (Article III, Section 5) establishes that the total amount of loans and guarantees shall not at any time exceed the sum of the unimpaired subscribed ordinary capital (paid-in and callable capital from all members) plus the general reserves. This would limit OLB to about US\$114.6 billion.
- **Borrowing Policy Limitation.** Pursuant to the borrowing policy approved by the Board of Executive Directors, net borrowings plus guarantees shall be limited to subscribed callable capital stock of the non-borrowing member countries, that is, US\$48.3 billion. Because the Bank's lending operations are funded with the unimpaired paid-in ordinary capital, general reserves, and net borrowings, (Charter, Article III Section 4) the Bank's borrowing policy effectively limits the Lending Authority to approximately US\$66.3 billion. For every additional dollar added to general reserves, the Lending Authority increases by one dollar.
- **Capital Adequacy.** Finally, and also approved by the Board of Executive Directors, the TELR (total-equity-to-loans ratio) is targeted at between 32 and 38 percent. Although this is not a lending limitation, current equity—including reserves—would support an OLB of between US\$51 billion and US\$61 billion based on the current capital adequacy model; and for every dollar added to reserves, "lending capacity" would increase by about US\$3. The framework (policy and model) for setting this limit is being reassessed to review assumptions and to include the broader range of market and credit risks the Bank is exposed to, as described in Chapter VI. The new framework is expected by the end of 2009, and it is possible that the resulting targeted range could be higher or lower than current levels.

- 7.6 There are several problems with the way loan approval limits have been put into practice at the IDB. First, demand for loans from the Bank will vary with economic cycles. It may be appropriate for the Bank to lend at higher levels in down cycles and at lower levels in up cycles. Since it will not be clear at the beginning of a planning horizon what the situation will be in two or three years, setting fixed loan approval limits for three or four years hampers the Bank's ability to play this countercyclical role. Having a fixed lending limit would also limit the Bank's ability to respond to exogenous shocks, such as commodity and food price increases. It is an approach that is focused on the Bank's financial

capacity to lend rather than the borrowers' need to pursue development opportunities as they may arise.

7.7 Second, following the Eighth Replenishment (notably for the 2002–05 and 2005–08 NLFs), the process for setting loan approval limits was complicated by the need to consider how loan approvals within the planning horizon would impact the Bank's ability to lend afterward. Capital contributions agreed under the Eighth Replenishment were very large (although mostly in the form of callable capital) with the understanding that there would not be another capital request for a long time. Because of this, loan approval limits needed to consider not just how they might affect OLB versus lending authority within a three, four, or five-year planning horizon, but also beyond. With the Eighth Capital Replenishment, the concept of a "sustainable lending level" was introduced. SLL was the annual level of loan approvals that could be sustained indefinitely, based on certain assumptions and estimates, without requiring additional capital from the Bank's members. Although SLL is a useful metric to show the scale of Bank lending operations that could be sustained over the medium to long term without requiring more capital, it has a couple of analytic constraints that should be noted:

- It shows the constant level of lending that could be done each year without exceeding the Lending Authority in any given year. For any given projection of SLL, there is a "crunch year" when the maximum Lending Authority is reached (within a predefined buffer). Additional lending room then opens up in the following years as the Bank's retained earnings increase its lending capacity. But SLL does not count this additional lending room. If the crunch year is far away, this is not a big problem. But if the crunch year occurs relatively soon, then SLL gives a misleadingly low estimate of medium-term future lending capacity.³³
- SLL is a nominal amount, not adjusted for inflation, because the callable capital of the Bank is in nominal terms. Therefore, in real terms the SLL is not constant but declines with inflation. As the real economy in the region grows, the SLL declines more sharply relative to the size of the economies of the region or their financing requirements.

7.8 Finally, OLB is also affected by factors other than loan approvals, most notably disbursement speed, exchange rates, prepayments, cancellations and loan sales. These other factors are of course estimated and taken into account when projecting how loan approvals will affect OLB. But as the other factors vary from the estimates, available lending room at the end of the planning horizon (or at some later point) may turn out to be more or less than expected. To account for the case in which variation in the other factors causes OLB to be higher than expected, a buffer must be kept. But no adjustment is made to the loan approvals limit for the case in which the other factors cause OLB to be lower than expected.

³³ This would be especially true if a temporary crunch were caused by the rapid disbursement and repayment of a large emergency loan.

In that instance, loan approvals would be curtailed in the last year of the horizon, based on loan approval limits set at the beginning but no longer justified as events have unfolded. This indeed was the situation in 2008 when the Bank was required under the 2005–08 NLF to limit approvals to less than its pipeline, although the lending constraint used to determine the original approval limits was not binding.

2. Lending Category Sub-ceilings

- 7.9 What had been the rationale for sub-ceilings? The Bank's Charter states that: *"Loans made or guaranteed by the Bank shall be principally for specific projects..."* (see Article III, Section 7 (a)-(vi)). This Charter provision has been interpreted as saying that the primary lending activity of the Bank should be investment lending, not policy-based lending. For that reason, and perhaps because their development effectiveness had not yet been demonstrated, PBLs have been separately constrained since their introduction with the Seventh Replenishment. In addition, because PBLs typically disburse faster than investment loans, they cause OLB to rise faster than is the case with investment loans. This means that a larger total volume of loans may be approved when PBLs are limited. Nonetheless, other than the expected pace of disbursement, there is little financial difference between a sovereign investment loan and a PBL as both generally flow through government budgets. Furthermore, other MDBs, most notably the World Bank, have used PBLs for many years as a development lending instrument. In fact, the World Bank has consolidated its various PBL instruments into a single product called the Development Policy Lending product.
- 7.10 Four problems have been noted with lending category sub-ceilings:
- Lending category sub-ceilings are set at the beginning of the planning horizon, and may unduly restrict the Bank's response to borrower demand and needs as economic conditions change over time. For example, in the wake of the 1997 Asian financial crisis, demand for PBLs outstripped expectations. The needs were such that the Bank participated in a multi-institutional effort by creating a one-time US\$9 billion emergency lending package for countries undergoing economic crisis. In 2008, the opposite occurred. In both cases, Management had to ask the Governors for adjustments.
 - Although policy-based loans tend to disburse faster on average, this financial feature is independent of the development purpose of the loan. It is also true that some investment loans have disbursed much faster than the average PBL.
 - As discussed elsewhere, the Bank should measure the development effectiveness of PBLs directly and without prejudice. There is no a priori reason that a PBL cannot be as developmentally effective as an investment loan.

- Finally, it should be noted that currently NSG financing is treated as part of the investment lending category, and therefore subject to the same sub-ceiling as sovereign guaranteed financing, though it is sometimes oriented to support public policy objectives rather than actual investments. NSG financing may be either public or private, as sovereign guaranteed loans are sometimes focused on promoting private enterprise. NSG financing, too, should be assessed for its development impact and considered within the context of the Bank's overall development objectives. Until risk analytics are improved and the Bank's capital adequacy model can illuminate trade-offs among the Bank's business lines, Management does not propose to amend the Governors' limit on NSG financing to 10 percent of the Bank's outstanding loan balance.

7.11 Notwithstanding the above, since the Seventh Replenishment when the Bank first began making PBLs, excluding emergency lending, approximately 77 percent of all Bank approvals have been investment loans, satisfying the Charter requirement mentioned above.

3. Conclusions

7.12 Annual loan approvals and lending by category are monitored closely. However, the Governors' recent practice of placing multi-year limits on both introduces unnecessary complexity to the management of the lending program. This is particularly true at this time when the needs of the Bank's borrowers are highly uncertain, given the current financial/economic environment.

7.13 Pre-set lending limits beyond the Lending Authority and sub-ceilings can become artificially binding, especially in the final year of the planning horizon, as new information overturns previous assumptions. The Charter and Board-approved risk management policies already provide adequate safeguards to constrain the Bank's lending program within approved limits. We therefore recommend that the Board of Executive Directors be given the responsibility of managing the lending program within Charter limits, maintaining the institutional flexibility to respond to new data and better carry out the Bank's mandate.

B. Proposed New Process for Establishing Periodic Lending Programs

7.14 Management recommends that the Board of Governors authorize the Board of Executive Directors to define the Bank's lending program based on estimated demand and the Bank's capacity to support high impact interventions. This would be done annually on the basis of Management's estimate of development opportunities that could be supported with financing from the Bank over the next two years.³⁴

³⁴ The Board of Governors has under consideration and for approval the *Proposal for a Liquidity Program for Growth Sustainability*. That proposal expressly contemplates the possibility that this Program would use resources from the

- 7.15 Management recommends this approach for the lending program (as opposed to a fixed four-year program) because it would:
- Provide the Bank with the flexibility to adjust lending volumes dynamically, taking into account the economic situation in the region
 - Make efficient use of the Bank's total lending capacity by allowing it to increase the lending volumes in the near term, precisely when it may be needed
 - Allow for better programming of the Bank's pipeline and allocation of resources
 - Allow Management to provide the Board of Executive Directors better estimates of borrowers' demand for a two year period, updated annually.
 - Be fully consistent with the proposal presented by OVE in its recent evaluation of the NLF (see document RE-342).
- 7.16 To properly adopt a two-year dynamic lending program, the Bank would also have to adopt a two-year budget cycle in order to assign resources to prepare and supervise execution of operations. Management envisions moving to this rolling two-year budget cycle when it begins discussing the 2010 budget with the Board.
- 7.17 Table 7.1 presents the results for illustrative lending programs that adhere to the Bank's current Borrowing Policy and the Lending Authority. Under each scenario, the table compares the volume of lending that the Bank could maintain after the two-year lending period, both in the form of the sustainable lending level³⁵ (SLL), and as an average lending volume through 2020.
- 7.18 Note that this "average annual lending capacity" is different from the SLL, which, as shown below, varies over a much wider range. Because the "crunch year" (the year in which OLB is most constrained) comes within a few years after the planning horizon ends, the analysis illustrates how the SLL can give a misleadingly low estimate of medium-term lending capacity, as was also noted by OVE in its evaluation of the NLF.

emergency lending category up to the full amount currently reserved for that category pursuant to prior mandates of the Board of Governors (ie. US\$ 6 billion). Further, the program is proposed to be available until December 31, 2009. As the NOF proposes that the Board of Executive Directors would determine the availability of resources for Emergency Loans, it is understood that up to US\$ 6 billion would be maintained as available for this lending category until December 31 of 2009, when the Governors mandate for the Liquidity Program would end.

³⁵ The SLL represents the annual lending program that could be sustained each year through the crunch year before increasing.

Table 7.1
Projected Lending Scenarios
(annual lending, in US\$ billions)

Based on Current Limitations				
2-year Lending program Scenarios	Initial 2009-2010 Annual regular (non-emerg)	Emergency lending "shock" (in first year)	SLL (Crunching Point)	Annual average lending capacity 2011 - 2020
A1	10 / 10		6.7 (2016)	7.2
A2	12 / 12		5.5 (2014)	6.8
A3	12 / 6	6.0	6.0 (2011)	7.7

- 7.19 Scenarios A1, and A2 assume two-year lending programs for 2009–10 as presented above, either \$10b each year in 2009/10 or \$12b each year. Scenario A3 assumes an additional \$6 billion emergency lending in 2009, on top of a lending program of \$12b.
- 7.20 As shown, under each scenario the average annual lending capacity after the two-year program can vary between \$6.8 and \$7.7 billion, while the SLL can vary between \$5.5 billion and \$6.7 billion. Note that in scenario A3 (with a \$6 billion emergency program), once the emergency loans are repaid (within five years), the Bank's lending capacity actually would be enhanced over the medium term because the extra earnings on emergency loan charges adds to reserves. This is why the average annual lending capacity is higher for scenario A3, even though the SLL is only \$6 billion.

VIII. NOF RECOMMENDATIONS

- 8.1 The NOF proposes the following recommendations for approval by the Board of Governors:
- 8.2 Recommendation 1: Eliminate the requirement that the Board of Governors determine Bank lending limits for four-year periods and sub-ceilings by category of lending. The Bank should continue supporting borrowing member countries through the three basic lending categories (Investment Lending, Policy-Based Lending and Emergency Lending) and others that may be created in the future. The sub ceilings on lending categories should be eliminated so that lending volumes and types can be adjusted based on the evolving needs of the region, subject to Charter and policy restrictions.
- 8.3 Accordingly the provisions of the Agreement on Measures for Enhancing the Response Capacity of the Inter-American Development Bank set forth in the Annex to Resolution AG-1/02, as amended, would remain in effect, except for the following modifications: (a) the Board of Executive Directors may create new categories of lending in the future; (b) the requirement that the Board of

Governors determine lending limits for four-year consecutive periods would be eliminated, and beginning 1 January, 2009, the Bank's lending volumes for all categories of lending would be determined by the Board of Executive Directors³⁶; and (c) the limitation on the revolving aggregate amount of the Ordinary Capital resources that may be approved for Emergency Loans would be eliminated and, beginning on 1 January of 2009, the availability of resources for these loans would be determined by the Board of Executive Directors. Any decision adopted by the Board of Executive Directors regarding new lending categories or the Bank's lending volumes shall at all times be consistent with the limitations established in the Charter and applicable Bank policies, including limitations on lending, categories of operations, limitations on borrowings and other applicable requirements.

- 8.4 **Recommendation 2: *Conduct a review of the implementation of the New Operational Framework.*** This review will be prepared for consideration by the Board of Governors at the Annual Meeting of the Board of Governors in 2014.
- 8.5 Accordingly, Management recommends that the Board of Executive Directors approve the Proposed Resolution attached as Annex 1-A so that the Proposed Resolution attached as Annex 1-B may be sent to the Board of Governors for consideration and approval.

³⁶This recommendation does not include a proposal to delegate to the Board of Executive Directors the authority to modify the limitations for non-sovereign guaranteed operations as set forth in Board of Governors Resolution AG-5/06.

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

PROPOSED RESOLUTION DE- /08

New Operational Framework

The Board of Executive Directors

RESOLVES:

That the proposed resolution concerning the New Operational Framework, be submitted to the Board of Governors for consideration by the procedure of taking a vote without calling a meeting provided for in Section 5 of the By-laws of the Bank.

The Governors may cast their votes by any rapid means of written communication. The proposed resolution shall be considered approved on the date on which the replies received at Bank headquarters constitute 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 the Agreement. The voting shall remain open until , 2008.

(Adopted on 2008)

PROPOSED RESOLUTION AG- /08

NEW OPERATIONAL FRAMEWORK

WHEREAS:

Pursuant to Resolution AG-1/02 of 1 March 2002, the Board of Governors approved the Agreement on Measures for Enhancing the Response Capacity of the Inter-American Development Bank (hereinafter the “Agreement”);

On 10 April 2005, pursuant to the recommendations of Management’s report contained in Document CA-450-1 - New Lending Framework: Assessment Report and Recommendations, the Board of Governors adopted Resolution AG-5/05 amending certain limitations and requirements of the Agreement;

Pursuant to Document CA-450-1, a review of the implementation of the Lending Framework for the period 2005-2008 would 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 Board of Governors on a subsequent lending framework for the period beginning in 2009;

Management presented to the Board of Executive Directors Document []:
[]: The New Operational Framework; and

The Board of Executive Directors has reviewed and considered Document [] and by Resolution DE- , agreed to submit for consideration of the Board of Governors, the proposed resolution concerning the New Operational Framework.

The Board of Governors

RESOLVES THAT:

The provisions of the Agreement shall remain in effect; provided, however, that:

- (a) The Board of Executive Directors may create new categories of lending in addition to the three categories referred to in the Agreement: Investment Loans, Policy Based Loans and Emergency Loans.
 - (b) The requirement set forth in Paragraph 4 of the Agreement, that the Board of Governors shall determine lending limits for Investment Loans, Policy-Based Loans and Emergency Loans, and disbursement limits for Policy-Based Loans, for consecutive four-year periods, shall be eliminated. Beginning on 1 January 2009, the lending volumes of the Bank for all categories of lending shall be determined by the Board of Executive Directors;
 - (c) The limitation set forth in Paragraph 12 of the Agreement, on the revolving aggregate amount that may be approved for Emergency Loans, shall be eliminated. Beginning on 1 January of 2009, the availability of resources for Emergency Loans shall be determined by the Board of Executive Directors; and.
 - (d) Any decision adopted by the Board of Executive Directors pursuant to paragraph 1(a), (b) and (c) of this Resolution shall at all times be consistent with the limitations established in the Agreement Establishing the Inter-American Development Bank and applicable Bank policies, including limitations on lending, categories of operations, limitations on borrowings and other applicable requirements.
2. A review of the implementation of the New Operational Framework described in Document [] will be prepared for consideration by the Board of Governors at its Annual Meeting in 2014.

(Adopted , 2008)

ANNEX 2**ENSURING AN EFFECTIVE ROLL-OUT OF THE NOF**

Implementation of the NOF will need to be properly sequenced and the speed with which each element becomes operational will be a function of the readiness of other related processes and policies in the Bank. The process will rely on and leverage the Bank's new matrix organization to involve various areas of the institution in the conception, design, and delivery of the multiple tasks required to implement the NOF. Furthermore, as each element of the NOF is implemented, the need to make further adjustments may emerge.

In addition to the actions put forth in the sequence below, the successful integration of the NOF in daily Bank operations will require changes in staff competencies and incentives. In particular, the NOF's increased focus on knowledge, analytical capacity, and development effectiveness represents a profound shift in institutional culture for some Bank personnel. Managing this change will require a combination of actions aimed at retaining adequately trained professionals and creating appropriate incentives that: (a) ensure an internal framework of accountability and; (b) coherently promote behaviors that are aligned with these strategic objectives. Thus, innovating Human Resources talent management and evaluation policies will be key to successfully implementing the NOF.

A. Tentative Implementation Plan

It is anticipated that the measures discussed in the NOF be presented and implemented over approximately 36 months, and that most activities will be completed in the first 18 months. By the 36th month it is foreseen that staff and management would have been sufficiently trained in most of the new instruments and processes.

The tentative timeline for NOF milestones, including the submission of policy proposals and other documents for Board approval or consideration is as follows:

Timeline of NOF Deliverables to the Board

	2008		2009				2010			
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
An integrated initiative for strengthening focus on development effectiveness										
Development Effectiveness Framework proposal	▲									
Country Strategy guidelines		▲								
Development Effectiveness overview							▲			
Provide high-value products aligned with client needs										
Financial instruments										
New lending rate methodology for OC loans		▲								
Proposal to eliminate adjustable rate pools		▲								
Proposal to eliminate commitment fees			▲							
Proposal for fixed spread for the life of the loan product						▲				
Knowledge and capacity-building products (KCP)										
KCP framework proposal		▲								
Increasing the Use of Country Systems										
Strategy to increase use of Country Systems proposal		▲								
Progress report on the use of Country Systems										▲
Improving the efficiency and analytical basis for managing Bank capital and income										
A System Approach for a New Model		▲								
Preliminary outlook of the New Framework			▲							
Preliminary outline of the new framework					▲					
Submission for approval of the revised policy and of amendments to other policies						▲				
Two year rolling lending forecast		▲				▲				▲

Policy proposal and other documents delivered to the board



Below are the specifics and timeframe on the tasks required for each of the elements.

1. An Integrated Initiative for Strengthening Focus on Development Effectiveness

Based on the Development Effectiveness Framework recently approved by the Board of Executive Directors, most tasks will take place during the remainder of 2008 and 2009:

- New Operations Manuals and Guidelines will be completed in Q4/08 to ensure that DEM requirements are reflected.
- In Q4/08, the new Country Strategy Guidelines observing DEF requirements will be submitted to the Board.
- Effective Q1/09, all sovereign guaranteed operations, technical cooperations, Country Strategies, and knowledge and capacity-building programs will require a Development Effectiveness Matrix.³⁷
- All sovereign guaranteed operations approved after January 2006 should have prepared a development effectiveness matrix by Q2/09.
- By Q2/09, all sovereign guaranteed projects approved under the New Project Cycle will monitor their execution under the new Project Monitoring Report.
- Country Strategy Monitoring Reports will be in use by Q2/09.
- The Development Effectiveness Overview will be submitted to the Board in Q1/10.
- Remaining sovereign guaranteed projects in the portfolio will be phased into the Project Monitoring Report by Q2/10.

³⁷ The private sector windows of the IDB Group already have DEMs in place and under implementation.

Integrated initiative for strengthening focus on development effectiveness Implementation Plan Timeline

	2008		2009				2010	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Development Effectiveness Framework proposal	▲							
NSG with DEM								
New Manuals and Guidelines								
Country Strategy guidelines		▲						
Country Strategy Monitoring Report								
SG and TCs with DEM								
Knowledge Capacity-Building Products with DEM								
New Project Monitoring Report								
Development Effectiveness overview							▲	
Remaining SG portfolio phased into PMR								→

Denotes that implementation will start after delivery



Policy proposal and other documents delivered to the board



2. Provision of High-Value Products Aligned with Client Needs

The two components (financial and knowledge and capacity-building products) include several elements, described below:

a. Financial Products

- In Q4/08, a new lending rate methodology for OC loans will be distributed to the Board.
- By Q4/08, a proposal to eliminate adjustable rate pools and offer adjustable facilities options for converting into market-based instruments to current borrowers under the Single Currency Facility and the Currency Pool System will be submitted to the Board.
- By Q1/09, a proposal to eliminate the commitment fee, on a revenue neutral basis, by replacing this fee with programmed disbursement schedules will be submitted to the Board.
- By Q3/09 the Single Currency Facility and Local Currency Facility, to offer similar financial terms and conversion/swap opportunities across currencies and rate types, will be fully integrated.
- Subject to the results of the capital adequacy model update, a proposal on fixed spreads for the life of the loan product, will be submitted to the Board.

b. Knowledge and capacity-building products (KCP)

- The Knowledge and Capacity-Building Framework proposal is expected to be presented to the Board by Q4/08.

- By Q2/09 a full survey of clients' attitudes and needs regarding the Bank's knowledge and capacity-building products will be undertaken.
- By Q2/09 a governance structure proposal for KCP will be adopted.
- It is expected that by Q2/09, information and reporting systems will be adjusted to provide accurate and consistent data on KCP as separate from operational and corporate inputs, independent of their funding sources.
- Implementation of the recommendations discussed above will require a carefully crafted transition strategy. A well-organized transition also may help incorporate KCP into the organizational culture of the Bank and signal to staff the seriousness of the organization's commitment. Internal training to adapt to the new arrangements is expected to start as soon as possible. It is anticipated that the transition strategy will be developed by Q2/09, after the additional work envisaged above has made substantial progress.

Provide high-value products aligned with client needs Implementation Plan Timeline

	2008		2009				2010	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Financial instruments								
New lending rate methodology for OC loans		▲						
Proposal elimination adjustable rate pools		▲						
Proposal eliminating commitment fees			▲					
Integration of SCF and LCF								
Elaboratio Proposal for fixed spread for the life of the loan product								
Elaboration of proposals for hedging products								
Knowledge and capacity-building products (KCP)								
KCP framework proposal		▲						
Survey of clients' attitudes about and needs for KCP								
KCP governance structure proposal								
Information system adjusted to incorporate KCP products								
Design a transition strategy								

Denotes that implementation will start after delivery

Policy proposal and other documents delivered to the board

Proposal subject to result of the capital adequacy update

3. Build-up and Utilization of Country Systems

The build-up and use of country systems will be informed by the Country Strategy cycle. Next steps will include:

- Compile and systematically review past diagnostic work, action plans agreed with governments, and baseline data by Q4/08.
- By Q4/08, present to the Board a proposal for a Strategy to Increase Use of Country Systems.

- Design methodologies to determine use of fiduciary (financial management and procurement) country systems for the execution of Bank-financed interventions by Q1/09.
- Review of fiduciary profiles to support implementation of the strategy by Q1/09.
- Preparation of Guidelines for Project Teams on how to apply the new strategy by Q2/09.
- After Q2/09, Country Strategies will increasingly integrate the use of country systems.
- By Q4/10, present to the Board a progress report on the use of country systems.

Move to build up and utilize country systems Implementation Plan Timeline

	2008		2009				2010	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Compilation, diagnostic, action plans and baseline data								
Strategy proposal		▲						
Design of methodologies for fiduciary systems								
Review of fiduciary profiles								
Preparation of guidelines								
Country Strategies increase use of Country Systems								
Progress report on the use of Country Systems								▲

Denotes that implementation will start after delivery



Policy proposal and other documents delivered to the board



4. Improved Efficiency of the Analytical Base for Managing the Bank's Capital and Income

The new Capital Adequacy framework will allow Management to properly analyze and report the risks by offering the following:

- A system approach for a new model will be presented to the Board in Q4/08.
- A preliminary outlook of the new framework will be presented to the Board by Q1/09.
- A preliminary outline of the new framework and required amendments to other policies will be presented to the Board by Q3/09.
- Submission for Board approval of any proposed revisions to capital management policies and of amendments to other related policies is foreseen for Q4/09.

Improving the efficiency and analytical basis for managing Bank capital and income Implementation Plan Timeline

	2008		2009			
	Q3	Q4	Q1	Q2	Q3	Q4
A System Approach for a New Model		▲				
Preliminary outlook of the New Framework			▲			
Preliminary outline of the new framework					▲	
Submission for aproval of the revised policy and of amendments to other policies						▲

Policy proposal and other documents delivered to the board ▲

5. Programming the Bank's operational program

Management will present to the Board in the fourth quarter of each year a rolling two-year forecast of demand and an operational program reflecting the Bank's capacity to meet that demand with high impact interventions.

B. Adapting Institutional Capacity

As the roll-out of the NOF progresses, management will continue to adjust systems and processes to take advantage of the Realignment and produce the results agreed with the Board. Following are some main topics to be addressed:

- a. Budget Process. As the 2009 Budget Issues Paper outlined, the 2009 budget includes resources for initiating the roll-out of the NOF. In particular, it accounts for resources for establishing the Development Effectiveness Framework, capital adequacy policy, and knowledge and capacity-building products. To consolidate the NOF, the Bank must also create new budgetary mechanisms that can: (a) provide medium-term certainty that sufficient resources are available for investments in knowledge and capacity building; and (b) eliminate the compartmentalization of Bank resources—administrative budget, initiatives, allocations from Ordinary Capital or from the Fund for Special Operations, and the like—to allow an integrated approach to budget development, planning, and execution.
- b. Information Systems. With the IT Roadmap study, Management has begun to review the Bank's IT architecture with an eye toward improving data production, collection, analysis, and use across the organization. The Roadmap will provide the Bank with three possible scenarios for the transformation. After a particular course of action is decided, a detailed scope for the selected scenario will be developed. In parallel, the Bank will implement tactical, targeted projects to solve pressing IT challenges.
- c. Human Resources. There will be close monitoring and assessment of any personnel allocation (sizing) and skill mix adjustments that may become necessary as the NOF begins implementation in 2009. For example, the Finance Department and Risk Management Office will receive additional headcounts in 2009.

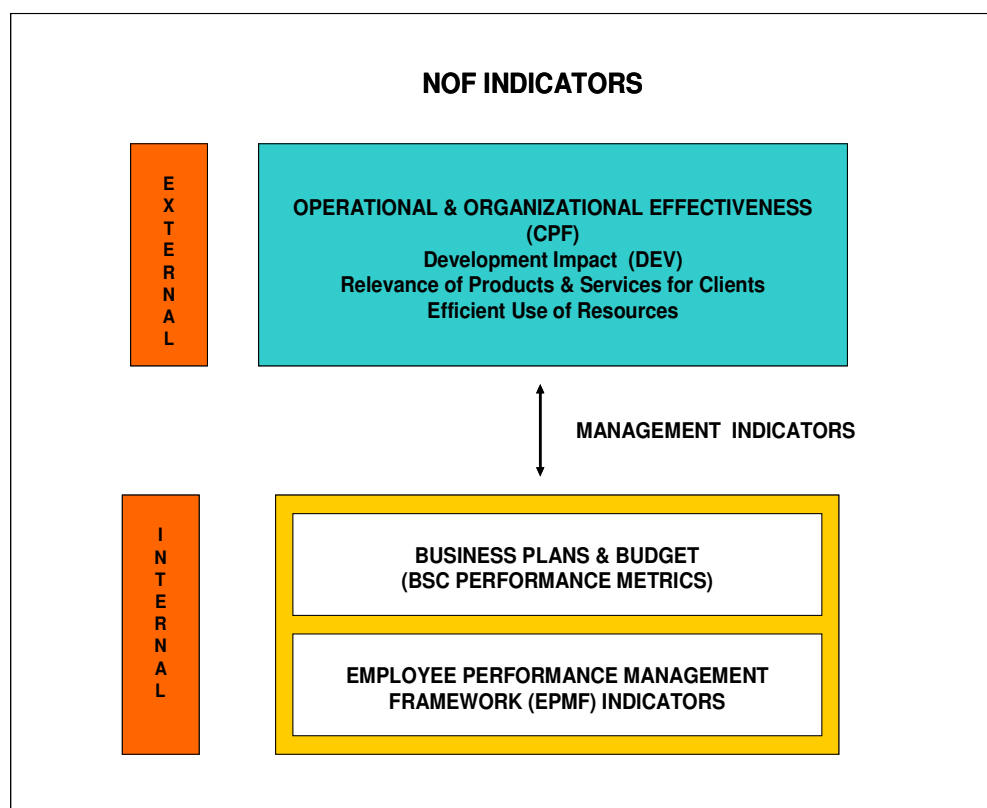
- d. Learning. Staff will require training on several aspects of the NOF. A proposed Integrated Training Program developed in 2008 and implemented in 2009 and 2010 will incorporate training for new financial and nonfinancial products as well as any new capital, income, and lending policies stemming from the NOF. This will ensure that all staff and management are prepared to operate in the new framework.
- e. Capacity for Analytical Work. To meet clients' needs effectively, the Bank's analytical work must become as valuable as its financial products. In order to achieve this, the Bank has to take advantage of opportunities for continuous learning occurs. Research must be integral to the Bank's work, with products of academic journal quality and sharply focused on the region's main policy challenges. Finally, loans, technical assistance, and KCPs, must be prepared and executed in an open environment, where criticism, debate, and discussion flourish.
- f. External Communication Strategy. The Bank will devise and deploy a roll-out strategy to inform borrowers on the scope of, and thus the benefits from, the new features/options being offered in the NOF.

C. Monitoring the New Operational Framework : Corporate Performance Framework

The results of the NOF will be monitored through the Bank's Corporate Performance Framework (GN 2480). The Corporate Performance Framework is a monitoring instrument at the corporate level that sets clear targets for improving aggregate performance to meet strategic institutional objectives. The indicators emerging from the Corporate Performance Framework will provide the Bank with the capability to monitor its operational and organizational effectiveness.

Figure 1 presents the indicators in the context of the wider monitoring structure that Management is currently developing. The indicators at the strategic level presented here will drive the indicators used by the rest of the system, including the Balanced Score Card (BSC) and Employee Performance Management Framework. The BSC will contribute to link long-term strategic objectives to short-term actions, integrating the set of objectives agreed on by Management to measure performance. The BSC is the operational vehicle of the Corporate Performance Framework. The Employee Performance Management Framework will cascade and align the Bank's strategies, goals, and indicators at the individual level.

Figure 1



Bank operational and organizational effectiveness. By improving performance in this dimension, the Bank can enhance its contribution to country outcomes and overall development effectiveness. The Corporate Performance Framework indicators shown below will allow the Bank to monitor progress in implementing the internal reforms that are considered essential to maintain relevance and highlight the results-oriented approach.

The Corporate Perform Framework will have most of its instruments developed, and its baseline and first targets established by Q1/09. In Q1/10, and every first quarter thereafter, Management will present the results of the previous year and agree on new targets with the Board.

CPF - Operational and Organizational Effectiveness	
Indicator	
Development Effectiveness (DEF)	
Country Focus	
Overall evaluability score at entry for new Country Strategies approved (% of max. score)	
% of Country Strategy CRM at exit that have satisfactory results validated for:	
<ul style="list-style-type: none"> - sector outcomes - financial outcomes - knowledge outcomes - progress for build and use country systems 	
Development Results	
% of new projects with satisfactory evaluability at entry	
% of PCRs with validated results	
% SG PCR satisfactory rating on	
<ul style="list-style-type: none"> - development results 	
% NSG XPSRs satisfactory ratings on	
<ul style="list-style-type: none"> - development outcomes - additionality 	
N/A	
<ul style="list-style-type: none"> - % SG projects with satisfactory rating on DEM environmental effects - % NSG projects with satisfactory rating on DEM environmental effects 	
% of completed KCP programs with results that can be validated and demonstrate positive results	
<ul style="list-style-type: none"> - % of DEM at exit with validated results - % of DEM at exit with satisfactory results 	
Relevance of Products and Services for Clients	
Client Satisfaction	
Rank of IDB with respect to other development partners in terms of:	
<ul style="list-style-type: none"> - relevance of knowledge products - relevance of financial products - responsiveness to clients needs - effectiveness as an implementation partner 	
Market Share	
Change of IDB Group's share of ⁽¹⁾ :	
<ul style="list-style-type: none"> - outstanding multilateral debt - outstanding portfolio of NSG operations - concessional (grants, co-financing, TC funds) resources delivered to the Region 	
Efficient Use of Resources	
Use of Human Resources	
Budgeted professional staff in operations departments (%)	
Budgeted professional staff in country offices (%)	
Representation of women in professional staff (%)	
Use of Budgetary Resources	
Internal administrative expenses per \$1 million of SG and NSG approvals (\$'000 in 2000 constant prices)	
Internal administrative expenses per loan approved (\$ million in 2000 constant prices)	
Internal administrative expenses per \$1 million loan disbursement (\$'000 in 2000 constant prices)	
Internal administrative expenses per loan under implementation (\$'000 in 2000 constant prices)	
Institutional Culture that lives by its Values	
Managerial Excellence	
% of supervisors and team leaders that measure favorably in leadership competencies	
Positive Work Environment	
% of staff that view that the Bank (engagement survey):	
<ul style="list-style-type: none"> - has an ethical work environment - is a meritocracy - has opportunities for career growth - has an environment that promotes collaborative work across organizational units 	
Diversity	
% of females in management placements (E,R, Grade 1) and in Senior grades (2 and 3)	
% of staff from indigenous and afro-descendant origins	

(1) The comparison will be relative to WB Group, CAF, CABEL, and CDB

MATRIX ON HOW OVEs RECOMMENDATIONS ON THE 2005-2008 NLF HAVE BEEN ADDRESSED

OVEs RECOMMENDATION	HOW ADDRESSED
<i>1. Lending Limits</i>	
<p>The 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 good projects” should be demonstrated by reference to development effectiveness standards and protocols that are currently in preparation.</p>	<p>The New Operational Framework proposes that the Bank's near term lending program be set based on estimated demand and the Bank's capacity to support high impact interventions, not the calculations of the Bank's financial lending capacity. Demand will be prioritized using the standards and protocols of the Development Effectiveness Framework (DEF), (approved by the Board of Executive Directors on October 15, 2008) to ensure that Bank resources are directed to projects with the greatest development impact.</p>
<p>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</p>	<p>The New Operational Framework (NOF) proposes that the Governors charge Management and the Board of Directors with setting a rolling two-year lending program based on estimated demand. These lending program projections would be dynamic in that every year, Management would re-estimate the demand amounts for the next year, and set the lending program to meet those volumes.</p>

<p>adjusting the envelope each year to take account of approvals, disbursements and cancellations experienced in the prior year.</p>	
<p>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.</p>	<p>The NOF proposes that the rolling two year lending program be subject to the limits established in the Bank's Charter, other applicable Bank policies and the development effectiveness of projects in the program. This will inform the Board, on an ongoing basis, where the lending program stands vis-à-vis the Bank's lending authority limits.</p>
<p>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.</p>	<p>Future adjustments to the Bank's current lending authority limits may result from the upcoming review of the Bank's capital adequacy model and policy. Any adjustments will ensure preservation of the Bank's AAA credit rating.</p>
<p><i>2. Country Programming</i></p>	
<p>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.</p>	<p>OVE's recommendation acknowledges that Management is meeting this requirement with the introduction of the Development Effectiveness Framework (DEF) for Country Strategies. The DEF was approved by the Board of Executive Directors on October 15, 2008.</p>
<p>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.</p>	<p>The Board of Directors of the Bank, in its meeting of June 25th, 2008 approved the new Country Strategy Guidelines and requested that Management present, as part of the DEF, a results framework for Country Strategies, aligned with the Good Practice Standards (GPS) of the MDB-ECG. The DEF complements the new Country Strategy guidelines by setting out the evaluation criteria, monitoring instruments and self-evaluation system for country strategies. In this way it allows for evidence-based assessments of the results of the Bank's interventions</p>

	<p>at the country level.</p> <p>In addition, the DEF states that to reach development effectiveness in Bank's interventions, it is fundamental to understand the scope of our work. This means to consolidate an approach that links sector analytic work, country analytic work, operations, and knowledge and capacity building services.</p> <p>The Country Results Matrix (CRM), to be included in all Country Strategies, maps the relationship between country objectives, Bank Program objectives, and the sector outcome indicators aligned to the country development indicators. It identifies the risks that could affect the achievement of agreed targets. In other words, it provides a logic-model of the Bank's future actions to achieve certain results, agreed with the country.</p> <p>At exit, the CRM compares actual results achieved with the expected results presented in the Country Strategy (or any adjustment made after). In addition, the CRMs are reviewed by SPD and receive partial scores, which are validated by OVE prior to the presentation of the new Strategy. The CRM is included in the new Country Strategy as part of the assessment of the previous programming cycle. This is meant to link the lessons learned and the outcomes of the strategy cycle with the development of the new Country Strategy, and ensure that the Bank recognizes both the contributions it made to development outcomes and any remaining challenges.</p>
<p>Country Strategy documents should be subject to quality review for the three dimensions of consistency, specificity and evaluability. Results of these quality reviews should accompany Country Strategy (CS) documents through the approval process.</p>	<p>Country Strategies will include CRMs at entry which will ensure that the quality of Country Strategies are reviewed and standards are met. This matrix will assess four criteria: Relevance, Effectiveness, Efficiency and Risks. These criteria encompass the dimensions requested by OVE to ensure quality. For each dimension SPD will assign a partial score on the degree of evaluability of the Country Strategy, and remit this information to the QRR Chair.</p>
<p>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.</p>	<p>There is no conflict between these documents. The Country Strategy provides the frame for the Country Business Plan, which is prepared each year as a management tool to plan the specific Bank interventions intended to meet country goals articulated in the Country Strategy. As noted in the Realignment Proposal (GA-232), the country business plan serves as a coordinating mechanism for the different Vice Presidencies in producing country program deliverables year to</p>

	<p>year. It is an inventory of the country program which provides details on the pipeline, its execution, as well as the costs of specific interventions. Country Business Plan could change as a result of adjustments in specific operations. Countries Strategies, on the other hand, do not require modification as long as the expected sector outcomes are not affected.</p>
<p>The analysis of risks to the implementation of the Country Strategy 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.</p>	<p>Risk analysis will be carried out throughout the country programming cycle. Risks will be assessed in two dimensions: 1) General risks (Macroeconomic, Institutional, Fiduciary; and Environmental and Social); and 2) sector risks, which define the fourth dimension of the CRM. For each category, mitigation measures must be included, especially in those sectors where the Bank will be focusing its interventions.</p> <p>These two dimensions will be assessed at entry, monitored during implementation and evaluated at exit in order to know the extent to which the Bank's operations (and outcomes) were affected, and the measures taken to address these risks.</p>
<p>3. Lending Instruments</p>	
<p>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.</p> <p>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.</p>	<p>A <i>Proposal for a New Framework of Lending Instruments</i> will be prepared in 2009. This proposal will :</p> <ul style="list-style-type: none"> • Take into account OVE's recommendations in its design. • Replace the current menu of lending instruments by a new framework that is simpler, more flexible and permits a tailor-made approach to the particular circumstances and needs of the project and client.
<p>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</p>	<p>The implementation of the DEF will provide greater focus on results in all Bank loans. It will provide the tools needed to continuously assess the performance of all Bank operations, and promote discipline in thinking about how to achieve and measure results. It also focuses on the Bank's incentive structure by aligning</p>

focus on the specification of their intended results, even if results are not required to trigger disbursements.	performance incentives with the achievement of development results.
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.	The NOF summarizes how Management intends to increase the use of country systems in IDB-finance operations. According to this proposal the Country Strategies will indicate those country systems that can be partially or entirely used in the execution of Bank projects. As for those systems that do not meet minimum standards, the Bank and the country authorities will determine the priorities and sector interventions that will be developed to improve them. Such interventions may be supported either by the Bank, by other donors, or by the country's own resources.
4. Mobilization and Analysis of Knowledge	
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.	<p>The purpose of the DEF is to provide the Bank with a framework to increase the effectiveness of all its interventions. This requires a programmatic approach by country and by sectors based on a clear understanding, through analytics, of the key development challenges and how they can be addressed.</p> <p>The NOF places knowledge and capacity building products as a core business of the Bank and summarizes a proposal for strengthening the Bank's ability to produce analytical work that is tailored to client needs and their development problems. This upcoming proposal establishes a comprehensive platform for planning, managing, monitoring, evaluating and sustainably financing the Bank's knowledge and capacity building products (KCP).</p> <p>Moreover, as stated in the DEF, an information system connected to existing product management systems of the Bank will be created to store, update and track information produced through the development effectiveness matrix (DEM) for knowledge and capacity building products (KCP). Storage of studies and documentation will be periodically tracked and reported.</p>
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	See Development Effectiveness and Country Programming sections.

<p>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.</p>	
<p>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.</p>	<p>In the Realignment a number of broad strategic areas have been identified in which the Bank <i>will develop and deepen its knowledge and technical capacity</i>. Alongside with the identification of strategic areas, greater value will be provided by creating niches of expertise within the VPs.</p> <p>The Bank's need to closely partner with other relevant actors in its analytical work is an important element of the NOF. The NOF stresses that Country Systems need to be jointly assessed with other development partners. Likewise, the new Country Strategy Guidelines and the DEF for Country Strategies, emphasize the need for strategies be aligned and complement the assistance provided by other development partners.</p>
<p><i>5. Development Effectiveness</i></p>	
<p>Develop 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 of every intervention with measurable indicators for each dimension of intent (evaluability); fully specify the intended results of interventions; and provide credible evidence of results obtained.</p>	<p>This will be achieved through the implementation of the Development Effectiveness Framework which:</p> <ul style="list-style-type: none"> • Describes a systematic model to articulate the development intent of the Bank at the country, sector, and project level and for knowledge and capacity building products (KCP) , establishing the logical consistency between each level and how the aggregate outcomes of interventions lead to the understanding of country level results. • Clearly identifies the theory of change that led to the definition of the Bank's scope of action in a country, through analytic work and dialogue with the country; • At the country level the Country Strategy articulates country and sector development goals, and aligns the Bank's area of action to these, identifying the expected outcomes that would be generated from an aggregate set of actions in any given sector by the Bank, and their contribution to a longer term development goal; • At the project level, the DEF requires that the project be aligned to the

	<p>Country Strategy objectives; that it demonstrate “value” to the country through cost-benefit or cost efficiency analysis.</p> <ul style="list-style-type: none"> • Requires that all KCP have a clear statement of objectives and expected development results, and be subject to evaluation. • Provides a framework to assess results at the end of a Bank intervention through an evidence-based self-assessment.
<p>The Bank’s approach to development needs to be country-focused rather than Bank-focused. The capacity to measure the results of Bank interventions need to be present in both the country and the Bank, and differences in this respect among countries need to be acknowledged and addressed.</p>	<p>The NOF recognizes the need to address development needs with a country-focused approach in three specific areas:</p> <ul style="list-style-type: none"> • Improving country programming, where the emphasis is on demand driven interventions that are aligned to country development goals and the Bank’s sector interventions; • Defining a strategy for using country systems, incorporating public management capacity building as an element for increasing the Bank’s use of country systems. The determination on their use will be incorporated in the Country Strategy, as well as the capacity building measures needed to achieve acceptable standards recognized internationally, and aligning all Bank interventions (including PRODEV) to the agreed actions. • Developing financial products intended to allow each country to manage its liabilities more effectively by phasing out the Bank’s non-market-standard products.
<p>Anticipate resource needs to develop the capacities to collect and analyze the information needed to measure results.</p>	<p>The 2009 budget proposal includes resources that will be required to establish the DEF. In this respect, the NOF recognizes that the Bank needs to create new budget mechanisms that provide medium-term certainty of resource allocation (multi-annual budgeting) and eliminates the compartments that classify Bank resources at the present time to have a more integrated approach to budget development, planning and execution.</p>
<p>Recognize the trade-off between development effectiveness and other institutional goals.</p>	<p>The Corporate Performance Framework recognizes that the Bank is managed through results measured in four dimensions, and that these involve trade-offs between resource and personnel allocation, between effectiveness and other</p>

	metrics.
The pursuit of development effectiveness requires an institutional focal point.	The Development Effectiveness Framework establishes a clear governance structure within its architecture, including a self-evaluation area where the OPC and SPD act as focal points for validating the results of self-assessments, as well as the evaluability of interventions based on the standards defined in the DEF
6. Evaluation insight for Future Lending Frameworks	
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 instruments or lending limits take attention away from the central mission of the Bank.	The <i>New Operational Framework</i> being proposed specifies institutional objectives, priority areas and specific recommendations on measures to achieve these objectives.
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.	The success of the NOF will be evaluated through the Bank's Corporate Performance Framework (CPF). The CPF sets clear targets for improving the Bank's performance to meet strategic institutional objectives and provides indicators to monitor progress towards their achievement.
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.	Applies to Board of Executive Directors.
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.	The NOF makes clear proposals on how to better measure and achieve results (DEF) and manage risk by providing guidance on how issues such as lending category sub ceilings, lending authority, and management of Bank capital and income could be more effectively and efficiently addressed. The NOF does not establish a desired TELR. Any adjustments to the TELR would only be proposed

<p>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.</p>	<p>once the Bank has the necessary analytical tools to better assess its balance sheet risks.</p>
<p>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.</p>	<p>Under the NOF the issue of “development risk” is addressed through the Development Effectiveness Framework and its application at the country strategy and programming levels (see section on country programming above) .</p>

Statistical Annex
New Lending Framework 2005-2008

Table 1
IDB Lending by Country Group (I & II)
(US\$ million)

<i>IBD Regular Lending</i>							<i>Emergency</i>						
Country	2002	2003	2004	2005	2006	2007	Country	2002	2003	2004	2005	2006	2007
Argentina	-	86.0	527.6	1,078.0	1,622.6	2,482.0	Argentina	-	1,900.0	-	-	-	-
Bahamas	-	-	3.5	34.7	8.8	5.0	Bahamas	-	-	-	-	-	-
Barbados	17.0	-	-	4.4	-	-	Barbados	-	-	-	-	-	-
Brazil	690.4	339.3	2,609.7	694.9	515.7	1,673.5	Brazil	-	-	-	-	-	-
Chile	15.0	142.5	22.7	40.6	212.2	117.5	Chile	-	-	-	-	-	-
Mexico	1,000.0	510.0	485.4	2,050.0	387.0	650.0	Mexico	-	-	-	-	-	-
Trinidad & Tobago	32.0	10.0	-	-	28.0	-	Trinidad & Tobago	-	-	-	-	-	-
Uruguay	233.5	260.0	99.5	268.3	189.8	100.4	Uruguay	500.0	-	-	-	-	-
Venezuela	28.0	-	5.0	910.2	25.0	150.0	Venezuela	-	-	-	-	-	-
Country Group I	2,015.9	1,347.8	3,753.5	5,081.1	2,989.1	5,178.4	Country Group I	500.0	1,900.0	-	-	-	-
Belize	-	-	-	-	25.0	-	Belize	-	-	-	-	-	-
Bolivia	228.2	223.5	92.6	48.0	153.0	84.3	Bolivia	-	-	-	-	-	-
Colombia	105.9	564.0	737.3	601.0	620.0	771.0	Colombia	-	1,250.0	-	-	-	-
Costa Rica	14.4	6.4	11.0	132.8	70.0	535.0	Costa Rica	-	-	-	-	-	-
Dominican Republic	290.0	30.8	137.0	55.0	181.0	80.5	Dominican Republic	-	-	200.0	-	-	-
Ecuador	75.0	232.9	17.4	103.0	326.9	484.3	Ecuador	-	-	-	-	-	-
El Salvador	70.3	100.0	20.0	210.9	100.0	-	El Salvador	-	-	-	-	-	-
Guatemala	321.8	112.5	100.0	18.9	239.0	215.0	Guatemala	-	-	-	-	-	-
Guyana	62.4	3.5	115.8	-	116.4	32.9	Guyana	-	-	-	-	-	-
Haiti	-	201.9	-	201.7	100.4	50.0	Haiti	-	-	-	-	-	-
Honduras	80.8	82.5	228.1	62.7	125.9	97.1	Honduras	-	-	-	-	-	-
Jamaica	33.0	30.0	56.8	-	5.0	-	Jamaica	-	-	-	-	-	-
Nicaragua	142.9	62.3	143.8	85.1	132.5	90.2	Nicaragua	-	-	-	-	-	-
Panama	67.6	53.3	-	74.6	304.7	188.1	Panama	-	-	-	-	-	-
Paraguay	28.4	32.4	-	39.2	254.1	61.3	Paraguay	-	30.0	-	-	-	-
Peru	488.0	523.9	350.3	345.0	565.0	940.0	Peru	-	-	-	-	-	-
Suriname	4.2	12.5	10.0	4.0	-	7.0	Suriname	-	-	-	-	-	-
Country Group II	2,012.9	2,272.3	2,020.2	1,981.9	3,318.9	3,636.7	Country Group II	-	1,280.0	200.0	-	-	-
Regional	20.0	-	40.0	85.0	60.0	200.0	Regional	-	-	-	-	-	-
Total	4,048.8	3,620.1	5,813.6	7,148.0	6,368.0	9,015.1	Total	500.0	3,180.0	200.0	-	-	-

Table 1 (continued)
IDB Lending by Country Group (I & II) – Regular Lending by Lending Categories
(US\$ million)

<i>Investment</i>							<i>Investment non-sovereign guarantee (NSG)</i>							<i>Policy Based Loans</i>						
Country	2002	2003	2004	2005	2006	2007	Country	2002	2003	2004	2005	2006	2007	Country	2002	2003	2004	2005	2006	2007
Argentina	-	86.0	27.6	1,033.0	1,122.6	2,482.0	Argentina	-	-	-	45.0	500.0	-	Argentina	-	-	500.0	-	-	-
Bahamas	-	-	3.5	34.7	8.8	5.0	Bahamas	-	-	-	-	-	-	Bahamas	-	-	-	-	-	-
Barbados	17.0	-	-	4.4	-	-	Barbados	-	-	-	-	-	-	Barbados	-	-	-	-	-	-
Brazil	690.4	220.4	2,341.7	321.9	148.8	1,126.8	Brazil	-	118.9	268.0	373.0	-	-	Brazil	-	-	-	-	366.8	546.6
Chile	15.0	60.5	22.7	40.6	115.2	117.5	Chile	-	82.0	-	-	-	-	Chile	-	-	-	-	97.0	-
Mexico	1,000.0	210.0	410.4	1,450.0	207.0	250.0	Mexico	-	-	75.0	-	-	-	Mexico	-	300.0	-	600.0	180.0	400.0
Trinidad & Tobago	32.0	10.0	-	-	28.0	-	Trinidad & Tobago	-	-	-	-	-	-	Trinidad & Tobago	-	-	-	-	-	-
Uruguay	223.0	60.0	77.0	18.3	139.8	25.3	Uruguay	10.5	-	22.5	-	50.0	75.0	Uruguay	-	200.0	-	250.0	-	-
Venezuela	28.0	-	5.0	910.2	25.0	150.0	Venezuela	-	-	-	-	-	-	Venezuela	-	-	-	-	-	-
Country Group I	2,005.4	646.9	2,888.0	3,813.1	1,795.3	4,156.8	Country Group I	10.5	200.9	365.5	418.0	550.0	75.0	Country Group I	-	500.0	500.0	850.0	643.8	946.6
Belize	-	-	-	-	-	-	Belize	-	-	-	-	25.0	-	Belize	-	-	-	-	-	-
Bolivia	116.2	73.5	61.6	33.0	145.0	84.3	Bolivia	112.0	-	31.0	-	-	-	Bolivia	-	150.0	-	15.0	8.0	-
Colombia	100.7	164.0	137.3	561.0	180.0	306.0	Colombia	5.2	-	-	40.0	400.0	300.0	Colombia	-	400.0	600.0	-	40.0	165.0
Costa Rica	14.4	6.4	11.0	132.8	70.0	250.0	Costa Rica	-	-	-	-	-	-	Costa Rica	-	-	-	-	-	285.0
Dominican Republic	140.0	30.8	37.0	25.0	31.0	80.5	Dominican Republic	150.0	-	-	30.0	150.0	-	Dominican Republic	-	-	100.0	-	-	-
Ecuador	75.0	32.9	17.4	13.0	264.9	356.3	Ecuador	-	-	-	90.0	50.0	-	Ecuador	-	200.0	-	-	12.0	128.1
El Salvador	70.3	-	-	210.9	-	-	El Salvador	-	-	20.0	-	100.0	-	El Salvador	-	100.0	-	-	-	-
Guatemala	96.8	112.5	-	18.9	139.0	80.0	Guatemala	25.0	-	-	-	100.0	100.0	Guatemala	200.0	-	100.0	-	-	35.0
Guyana	62.4	3.5	100.8	-	83.4	20.9	Guyana	-	-	-	-	33.0	12.0	Guyana	-	-	15.0	-	-	-
Haiti	-	176.9	-	176.7	75.4	37.5	Haiti	-	-	-	-	25.0	12.5	Haiti	-	25.0	-	25.0	-	-
Honduras	67.1	82.5	173.1	62.7	60.0	97.1	Honduras	13.7	-	-	-	57.9	-	Honduras	-	-	55.0	-	8.0	-
Jamaica	33.0	-	56.8	-	0.0	0.0	Jamaica	-	30.0	-	-	-	-	Jamaica	-	-	-	-	5.0	-
Nicaragua	112.9	37.3	143.8	85.1	94.5	80.2	Nicaragua	-	-	-	-	30.0	-	Nicaragua	30.0	25.0	-	-	8.0	10.0
Panama	67.6	53.3	-	34.6	204.7	176.0	Panama	-	-	-	40.0	100.0	-	Panama	-	-	-	-	-	12.0
Paraguay	28.4	32.4	-	9.2	249.1	61.3	Paraguay	-	-	-	-	-	-	Paraguay	-	-	-	30.0	5.0	-
Peru	188.0	120.9	50.3	145.0	215.0	55.0	Peru	-	103.0	-	-	200.0	375.0	Peru	300.0	300.0	300.0	200.0	150.0	510.0
Suriname	4.2	12.5	10.0	4.0	0.0	0.0	Suriname	-	-	-	-	-	-	Suriname	-	-	-	-	-	7.0
Country Group II	1,177.0	939.3	799.2	1,511.9	1,812.0	1,685.1	Country Group II	305.9	133.0	51.0	200.0	1,270.9	799.5	Country Group II	530.0	1,200.0	1,170.0	270.0	236.0	1,152.1
Regional	20.0	-	-	10.0	-	-	Regional	-	-	40.0	75.0	-	-	Regional	-	-	-	-	60.0	200.0
Total	3,202.4	1,586.2	3,687.1	5,335.0	3,607.3	5,841.9	Total	316.4	333.9	456.5	693.0	1,820.9	874.5	Total	530.0	1,700.0	1,670.0	1,120.0	939.8	2,298.7

Table 2
IDB Lending by Country Group (A, B, C, D)
(US\$ million)

<i>IDB Regular Lending</i>							<i>Emergency</i>						
Country	2002	2003	2004	2005	2006	2007	Country	2002	2003	2004	2005	2006	2007
Argentina	-	86.0	527.6	1,078.0	1,622.6	2,482.0	Argentina	-	1,900.0	-	-	-	-
Brazil	690.4	339.3	2,609.7	694.9	515.7	1,673.5	Brazil	-	-	-	-	-	-
Mexico	1,000.0	510.0	485.4	2,050.0	387.0	650.0	Mexico	-	-	-	-	-	-
Venezuela	28.0	-	5.0	910.2	25.0	150.0	Venezuela	-	-	-	-	-	-
Country Group A	1,718.4	935.3	3,627.7	4,733.1	2,550.3	4,955.5	Country Group A	-	1,900.0	-	-	-	-
Chile	15.0	142.5	22.7	40.6	212.2	117.5	Chile	-	-	-	-	-	-
Colombia	105.9	564.0	737.3	601.0	620.0	771.0	Colombia	-	1,250.0	-	-	-	-
Peru	488.0	523.9	350.3	345.0	565.0	940.0	Peru	-	-	-	-	-	-
Country Group B	608.9	1,230.4	1,110.4	986.6	1,397.2	1,828.5	Country Group B	-	1,250.0	-	-	-	-
Bahamas	-	-	3.5	34.7	8.8	5.0	Bahamas	-	-	-	-	-	-
Barbados	17.0	-	-	4.4	-	-	Barbados	-	-	-	-	-	-
Costa Rica	14.4	6.4	11.0	132.8	70.0	535.0	Costa Rica	-	-	-	-	-	-
Jamaica	33.0	30.0	56.8	-	5.0	-	Jamaica	-	-	-	-	-	-
Panama	67.6	53.3	-	74.6	304.7	188.1	Panama	-	-	-	-	-	-
Suriname	4.2	12.5	10.0	4.0	-	7.0	Suriname	-	-	-	-	-	-
Trinidad & Tobago	32.0	10.0	-	-	28.0	-	Trinidad & Tobago	-	-	-	-	-	-
Uruguay	233.5	260.0	99.5	268.3	189.8	100.4	Uruguay	500.0	-	-	-	-	-
Country Group C	401.7	372.2	180.8	518.8	606.4	835.5	Country Group C	500.0	-	-	-	-	-
Belize	-	-	-	-	25.0	-	Belize	-	-	-	-	-	-
Bolivia	228.2	223.5	92.6	48.0	153.0	84.3	Bolivia	-	-	-	-	-	-
Dominican Republic	290.0	30.8	137.0	55.0	181.0	80.5	Dominican Republic	-	-	200.0	-	-	-
Ecuador	75.0	232.9	17.4	103.0	326.9	484.3	Ecuador	-	-	-	-	-	-
El Salvador	70.3	100.0	20.0	210.9	100.0	-	El Salvador	-	-	-	-	-	-
Guatemala	321.8	112.5	100.0	18.9	239.0	215.0	Guatemala	-	-	-	-	-	-
Guyana	62.4	3.5	115.8	-	116.4	32.9	Guyana	-	-	-	-	-	-
Haiti	-	201.9	-	201.7	100.4	50.0	Haiti	-	-	-	-	-	-
Honduras	80.8	82.5	228.1	62.7	125.9	97.1	Honduras	-	-	-	-	-	-
Nicaragua	142.9	62.3	143.8	85.1	132.5	90.2	Nicaragua	-	-	-	-	-	-
Paraguay	28.4	32.4	-	39.2	254.1	61.3	Paraguay	-	30.0	-	-	-	-
Country Group D	1,299.8	1,082.3	854.7	824.5	1,754.2	1,195.6	Country Group D	-	30.0	200.0	-	-	-
Regional	20.0	-	40.0	85.0	60.0	200.0	Regional	-	-	-	-	-	-
Total	4,048.8	3,620.1	5,813.6	7,148.0	6,368.0	9,015.1	Total	500.0	3,180.0	200.0	-	-	-

Table 2 (continued)
IDB Lending by Country Group (A, B, C, D) – Regular Lending by Lending Categories
(US\$ million)

<i>Investment</i>							<i>Investment non-sovereign guarantee (NSG)</i>							<i>Policy Based Loans</i>						
Country	2002	2003	2004	2005	2006	2007	Country	2002	2003	2004	2005	2006	2007	Country	2002	2003	2004	2005	2006	2007
Argentina	-	86.0	27.6	1,033.0	1,122.6	2,482.0	Argentina	-	-	-	45.0	500.0	-	Argentina	-	-	500.0	-	-	-
Brazil	690.4	220.4	2,341.7	321.9	148.9	1,126.9	Brazil	-	118.9	268.0	373.0	-	-	Brazil	-	-	-	-	366.8	546.6
Mexico	1,000.0	210.0	410.4	1,450.0	207.0	250.0	Mexico	-	-	75.0	-	-	-	Mexico	-	300.0	-	600.0	180.0	400.0
Venezuela	28.0	-	5.0	910.2	25.0	150.0	Venezuela	-	-	-	-	-	-	Venezuela	-	-	-	-	-	-
Country Group A	1,718.4	516.4	2,784.7	3,715.1	1,503.5	4,008.9	Country Group A	-	118.9	343.0	418.0	500.0	-	Country Group A	-	300.0	500.0	600.0	546.8	946.6
Chile	15.0	60.5	22.7	40.6	115.2	117.5	Chile	-	82.0	-	-	-	-	Chile	-	-	-	-	97.0	-
Colombia	100.7	164.0	137.3	561.0	180.0	306.0	Colombia	5.2	-	-	40.0	400.0	300.0	Colombia	-	400.0	600.0	-	40.0	165.0
Peru	188.0	120.9	50.3	145.0	215.0	55.0	Peru	-	103.0	-	-	200.0	375.0	Peru	300.0	300.0	300.0	200.0	150.0	510.0
Country Group B	303.7	345.4	210.4	746.6	510.2	478.5	Country Group B	5.2	185.0	-	40.0	600.0	675.0	Country Group B	300.0	700.0	900.0	200.0	287.0	675.0
Bahamas	-	-	3.5	34.7	8.8	5.0	Bahamas	-	-	-	-	-	-	Bahamas	-	-	-	-	-	-
Barbados	17.0	-	-	4.4	-	-	Barbados	-	-	-	-	-	-	Barbados	-	-	-	-	-	-
Costa Rica	14.4	6.4	11.0	132.8	70.0	250.0	Costa Rica	-	-	-	-	-	-	Costa Rica	-	-	-	-	-	285.0
Jamaica	33.0	-	56.8	-	-	-	Jamaica	-	30.0	-	-	-	-	Jamaica	-	-	-	-	5.0	-
Panama	67.6	53.3	-	34.6	204.7	176.1	Panama	-	-	-	40.0	100.0	-	Panama	-	-	-	-	-	12.0
Suriname	4.2	12.5	10.0	4.0	-	-	Suriname	-	-	-	-	-	-	Suriname	-	-	-	-	-	7.0
Trinidad & Tobago	32.0	10.0	-	-	28.0	-	Trinidad & Tobago	-	-	-	-	-	-	Trinidad & Tobago	-	-	-	-	-	-
Uruguay	223.0	60.0	77.0	18.3	139.9	25.4	Uruguay	10.5	-	22.5	-	50.0	75.0	Uruguay	-	200.0	-	250.0	-	-
Country Group C	391.2	142.2	158.3	228.8	451.4	456.5	Country Group C	10.5	30.0	22.5	40.0	150.0	75.0	Country Group C	-	200.0	-	250.0	5.0	304.0
Belize	-	-	-	-	-	-	Belize	-	-	-	-	25.0	-	Belize	-	-	-	-	-	-
Bolivia	116.2	73.5	61.6	33.0	145.00	84.3	Bolivia	112.0	-	31.0	-	-	-	Bolivia	-	150.0	-	15.0	8.0	-
Dominican Republic	140.0	30.8	37.0	25.0	31.00	80.5	Dominican Republic	150.0	-	-	30.0	150.0	-	Dominican Republic	-	-	100.0	-	-	-
Ecuador	75.0	32.9	17.4	13.0	264.94	356.3	Ecuador	-	-	-	90.0	50.0	-	Ecuador	-	200.0	-	-	12.0	128.1
El Salvador	70.3	-	-	210.9	-	-	El Salvador	-	-	20.0	-	100.0	-	El Salvador	-	100.0	-	-	-	-
Guatemala	96.8	112.5	-	18.9	139.0	80.0	Guatemala	25.0	-	-	-	100.0	100.0	Guatemala	200.0	-	100.0	-	-	35.0
Guyana	62.4	3.5	100.8	-	83.4	20.9	Guyana	-	-	-	-	33.0	12.0	Guyana	-	-	15.0	-	-	-
Haiti	-	176.9	-	176.7	75.4	37.5	Haiti	-	-	-	-	25.0	12.5	Haiti	-	25.0	-	25.0	-	-
Honduras	67.1	82.5	173.1	62.7	60.0	97.1	Honduras	13.7	-	-	-	57.9	-	Honduras	-	-	55.0	-	8.0	-
Nicaragua	112.9	37.3	143.8	85.1	94.5	80.2	Nicaragua	-	-	-	-	30.0	-	Nicaragua	30.0	25.0	-	-	8.0	10.0
Paraguay	28.4	32.4	-	9.2	249.1	61.3	Paraguay	-	-	-	-	-	-	Paraguay	-	-	-	30.0	5.0	-
Country Group D	769.1	582.3	533.7	634.5	1,142.3	898.1	Country Group D	300.7	-	51.0	120.0	570.9	124.5	Country Group D	230.0	500.0	270.0	70.0	41.0	173.1
Regional	20.0	-	-	10.0	-	-	Regional	-	-	40.0	75.0	-	-	Regional	-	-	-	-	60.0	200.0
Total	3,202.4	1,586.2	3,687.1	5,335.0	3,607.3	5,841.9	Total	316.4	333.9	456.5	693.0	1,820.9	874.5	Total	530.0	1,700.0	1,670.0	1,120.0	939.8	2,298.7

Table 3
Net Flows of Convertible Currencies, by Country Group
(US\$ million)

Country	2005					2006					2007				
	Disburse- ments	Repay- ments	Net loan flow	Other charges	Net cash flows	Disburse- ments	Repay- ments	Net loan flow	Other charges	Net cash flows	Disbur- sements	Repay- ments	Net loan flow	Other charges	Net cash flows
Argentina	578.6	517.4	61.2	489.7	(428.5)	1,107.3	1,237.5	(130.2)	513.3	(643.5)	1,482.6	1,507.9	(25.3)	511.1	(536.4)
Brazil	1,489.5	823.6	665.9	569.4	96.5	1,720.3	871.7	848.6	582.9	265.7	1,617.8	859.4	758.4	666.6	91.8
Mexico	930.1	644.5	285.6	366.5	(80.9)	620.6	4,359.3	(3,738.7)	405.8	(4,144.5)	1,058.2	702.6	355.6	231.1	124.5
Venezuela	70.8	253.1	(182.3)	132.4	-314.7	73.0	237.3	(164.3)	108.6	-272.9	167.2	597.3	(430.1)	70.5	-500.6
Country Group A	3,069.0	2,238.6	830.4	1,558.0	(727.6)	3,521.2	6,705.8	(3,184.6)	1,610.6	(4,795.2)	4,325.8	3,667.2	658.6	1,479.3	(820.7)
Chile	114.3	162.0	(47.7)	46.6	(94.3)	31.0	25.3	5.7	51.5	(45.8)	41.2	41.1	0.1	31.3	(31.2)
Colombia	361.6	1,522.9	(1,161.3)	234.9	(1,396.2)	949.4	270.8	678.6	201.3	477.3	765.2	291.9	473.3	244.8	228.5
Peru	459.9	203.7	256.2	163.2	93.0	467.5	236.4	231.1	177.5	53.6	490.1	249.2	240.9	205.8	35.1
Country Group B	935.8	1,888.6	(952.8)	444.7	(1,397.5)	1,447.9	532.5	915.4	430.3	485.1	1,296.5	582.2	714.3	481.9	232.4
Bahamas	5.0	3.6	1.4	3.7	(2.3)	7.1	4.9	2.2	3.5	(1.3)	9.5	5.5	4.0	5.4	(1.4)
Barbados	4.4	12.2	(7.8)	7.1	(14.9)	2.2	15.6	(13.4)	6.5	(19.9)	2.8	15.9	(13.1)	6.3	(19.4)
Costa Rica	41.6	208.9	(167.3)	41.2	(208.5)	22.5	78.5	(56.0)	27.3	(83.3)	12.9	81.7	(68.8)	24.5	(93.3)
Jamaica	12.8	51.2	(38.4)	35.2	(73.6)	25.9	64.1	(38.2)	32.4	(70.6)	34.3	83.5	(49.2)	28.9	(78.1)
Panama	80.1	76.4	3.7	41.8	(38.1)	139.7	89.1	50.6	41.8	8.8	74.9	79.4	(4.5)	46.0	(50.5)
Suriname	4.9	2.9	2.0	1.8	0.2	7.7	3.0	4.7	1.9	2.8	16.8	3.5	13.3	2.5	10.8
Trinidad & Tobago	52.7	61.0	(8.3)	21.4	(29.7)	23.8	64.1	(40.3)	18.3	(58.6)	47.2	39.7	7.5	18.4	(10.9)
Uruguay	242.3	222.3	20.0	115.9	(95.9)	114.8	520.8	(406.0)	107.3	(513.3)	112.9	142.1	(29.2)	101.2	(130.4)
Country Group C	443.8	638.5	(194.7)	268.1	(462.8)	343.7	840.1	(496.4)	239.0	(735.4)	311.3	451.3	(140.0)	233.2	(373.2)
Belize	2.9	2.5	0.4	3.5	(3.1)	12.3	3.7	8.6	3.6	5.0	20.2	3.9	16.3	5.2	11.1
Bolivia	142.3	74.0	68.3	32.0	36.3	62.7	76.4	(13.7)	32.9	(46.6)	46.0	58.0	(12.0)	20.1	(32.1)
Dominican Republic	135.7	67.0	68.7	59.8	8.9	118.1	73.3	44.8	64.4	(19.6)	109.6	171.7	(62.1)	67.9	(130.0)
Ecuador	36.6	142.6	(106.0)	74.4	(180.4)	160.9	138.6	22.3	70.0	(47.7)	200.4	97.1	103.3	55.1	48.2
El Salvador	91.6	97.3	(5.7)	61.8	(67.5)	90.0	87.7	2.3	63.4	(61.1)	96.2	88.3	7.9	64.7	(56.8)
Guatemala	32.9	56.1	(23.2)	43.1	(66.3)	130.3	63.2	67.1	52.1	15.0	238.8	56.4	182.4	55.1	127.3
Guyana	49.6	6.4	43.2	4.9	38.3	46.5	7.6	38.9	5.7	33.2	48.8	4.2	44.6	2.6	42.0
Haiti	70.0	11.9	58.1	10.2	47.9	65.7	16.4	49.3	11.6	37.7	101.9	9.1	92.8	13.4	79.4
Honduras	65.0	32.2	32.8	17.3	15.5	91.6	32.3	59.3	17.4	41.9	66.4	18.9	47.5	9.1	38.4
Nicaragua	121.5	9.8	111.7	9.0	102.7	123.6	19.9	103.7	16.6	87.1	113.3	10.4	102.9	8.9	94.0
Paraguay	52.4	62.2	(9.8)	39.7	(49.5)	72.5	64.8	7.7	34.5	(26.8)	74.0	86.2	(12.2)	36.0	(48.2)
Country Group D	800.5	562.0	238.5	355.7	(117.2)	974.2	583.9	390.3	372.2	18.1	1,115.6	604.2	511.4	338.1	173.3
Regional	43.9	93.3	(49.4)	40.5	(89.9)	125.9	139.4	(13.5)	42.0	(55.5)	35.4	94.0	(58.6)	40.7	(99.3)
Total	5,293.0	5,421.0	(128.0)	2,667.0	(2,795.0)	6,412.9	8,801.7	(2,388.8)	2,694.1	(5,082.9)	7,084.6	5,398.9	1,685.7	2,573.2	(887.5)

Note: A negative cash flow indicates a negative flow to the country