

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**ANNUAL REPORT OF THE CHAIRPERSON OF THE
BUDGET AND FINANCIAL POLICIES COMMITTEE
1 JULY 2012 – 30 JUNE 2013**

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Annual Report of the Chairperson of the Budget and Financial Policies Committee

1 July 2012 – 30 June 2013

From 1 July 2012 to 30 June 2013, the Budget and Financial Policies Committee met on 41 occasions. Five of these were informal meetings, and 12 were joint meetings with other Committees of the Board of Executive Directors: 5 with the Audit Committee, 4 with the Policy and Evaluation Committee, and 3 with the Organization, Human Resources, and Board Matters Committee. A total of 15 Chairperson reports were prepared and submitted to the Board of Executive Directors.

The Committee's work focused mainly on recurring matters, including consideration and approval of the administrative budget, pricing of sovereign guaranteed loans, approval of the borrowing program, and the quarterly discussion of Ordinary Capital financial risk. During consideration of the budget, the need was noted to continue improving the discussion of the Bank's budget cycle with a view to balancing the budget process, deepening budget execution monitoring with respect to prior years, and simplifying the budget presentation process without loss of depth.

The establishment of two special programs (Broadband and Biodiversity) was also approved, as was the creation of three funds: the Forest Carbon Partnership Facility, the China Co-Financing Fund, and the pilot partnership between the Office of Evaluation and Oversight (OVE) and the Swiss Agency for Development and Cooperation. Three funds were also modified: the Clean Technology Fund, the Multidonor Fund for the Emerging and Sustainable Cities Initiative, and the Regional Fund for Agricultural Technology (FONTAGRO).

Lastly, in regard to financial mechanisms, the establishment of a leverage mechanism for grant resources allocated to countries receiving resources from the Fund for Special Operations (FSO) and a Reallocation program were approved.

I. FINANCIAL PROGRAMMING, INCOME MANAGEMENT MODEL, AND 2013 BUDGET

The Budget and Financial Policies Committee held 11 formal meetings from 5 November to 11 December, to consider Management's 2013 Program and Budget Proposal, set forth in document GA-252-3.

The formal meetings began with a review of the Bank's long-term financial projections (document FN-675-1) and a strategic overview of the program and budget proposal, followed by a series of presentations on each of the Bank's organizational units.

During the budget discussion, Management presented document GN-2599-25, containing a proposal to modify the process for Board consideration of the Bank's annual contributions to the retirement and post-retirement benefits plans.

Following discussion of whether the Bank's annual contributions to the plans should be separated from the budget discussion, the Committee arrived at a consensus solution and resolved that the actuarial estimate of the contribution would continue to be included in the budget document for information, and that the contributions would be considered after the final actuarial calculations were available. The new process would also enable the Executive Directors to consider the contributions in a more complete manner and in the proper context, that is, the financing of long-term obligations and monitoring and control of investment risk, rather than as a nondiscretionary budget item.

Lastly, a wrap-up meeting was held to finalize the Committee's recommendations to the Board. At the meeting, following the practice observed in past years when it was agreed to defer the decision on loan charges until the end of the budget process, the Committee, by a majority, accepted Management's option of increasing the lending spreads to 84 basis points while maintaining the credit spread of 25 basis points.

As a final recommendation, the Committee submitted for Board approval an administrative budget with a real increase of 3.6% (6.4% nominal); total financing for Special Programs/Grants of US\$100 million; and a budget of US\$48.9 million for improvements.

II. 2012 PROGRAM AND BUDGET EXECUTION

2012 Program and budget execution report as of 30 June 2012 and 31 December 2012 (documents GA-248-8 and GA-248-10)

Unlike in previous years when these documents had been presented to the Committee for information, on this occasion they were included on the Committee's agenda for discussion, as an experiment. The purpose was to determine whether the Executive Directors found it useful to incorporate these reports as part of the Committee's discussion of the budget process.

The Committee took note of the reports submitted by Management and the comments made by the Executive Directors. A large majority of Committee members supported the proposal to incorporate consideration of the execution reports into the Bank's budgeting process, striking the right balance between the time devoted to approval and to the discussion on budget execution.

Management's new proposal on discussion of the budget cycle included a midyear execution report focusing on the main achievements and challenges, and a year-end execution report providing a detailed description of operational and nonoperational accomplishments, full budget execution, and a detailed results-based budgeting (RBB) report.

III. FINANCIAL MECHANISMS

Proposal for the establishment of a Reallocation Program (document FN-672)

The Budget and Financial Policies Committee and the Policy and Evaluation Committee met on 19 July 2012 to discuss the Proposal for the Establishment of a Reallocation Program (document FN-672), the purpose of which was to offer borrowing member countries additional flexibility in allocating their exposure with the Bank by earmarking the resources freed up by a borrower prepaying a loan to finance new loan operations to that same borrower.

The Executive Directors generally supported the proposal and viewed the additional flexibility to respond to client needs in positive terms. Management was asked to prepare a revised version of the document reflecting the points raised in discussion, and as no objections were subsequently raised, the revised version was submitted for the Board's approval.

Grant Leverage Mechanism: A proposal (document GN-2711)

Management presented a proposal to establish a Grant Leverage Mechanism, on a pilot basis, that would be financed using resources from the Bank's Ordinary Capital and grant resources from bilateral and multilateral donors in accordance with the framework described in document GN-2711. The Chairpersons of the Budget and Financial Policies Committee and the Policy and Evaluation Committee concluded, with the agreement of the majority of the Executive Directors, that the proposal would be submitted to the Board of Executive Directors with the changes discussed in the meeting room, to authorize its submission to the Board of Governors, and that the report of the Committee Chairpersons would reflect the concerns expressed by the Executive Directors, particularly with regard to the FSO's financial position.

IV. FINANCIAL POLICIES AND RISK MANAGEMENT

Periodic financial risk reports on the Ordinary Capital (documents FN-673, FN-673-1, FN-673-2, FN-673-3, and FN-682)

The Committee met jointly with the Audit Committee on five occasions to consider these quarterly reports. At the first meeting, it was proposed that the advance circulation requirements applicable to future financial risk reports be shortened to five business days, so that Management could include more recent data and the document could be discussed as near as possible to the close of the quarter. The Committee supported the proposal, was pleased with the quality of the reports delivered, which showed significant improvement over previous versions, and took note of the documents.

Other financial policy matters

The Committee submitted a recommendation for consideration by the Committee of the Whole to approve document FN-679-1: Borrowing Program for 2013; and document GP-117-29: Proposed Amendments to Board Resolution DE-159/10, “Authorization to Invest Bank Funds.”

V. FUNDS

Proposal for the establishment of the Readiness Fund of the Forest Carbon Partnership Facility (FCPF-RF) in the Inter-American Development Bank (document GN-2675)

Management submitted the above proposal to seek approval from the Board of Executive Directors for the Bank (a) to enter into and sign a transfer agreement with the World Bank, whereby the World Bank—as depository of the FCPF-RF—would transfer Readiness Fund resources to the IDB; and (b) to become a delivery partner of the FCPF-RF and facilitate access to Readiness Fund resources by the REDD+ country participants that have selected the Bank as their delivery partner. The Committee agreed to recommend Board approval of Management’s proposal.

Proposal for the establishment of the China Cofinancing Fund for Latin America and the Caribbean (document GN-2686)

In response to growing demand for Bank loans in the region and China’s interest in financing them, subject to certain conditions, Management proposed to establish the above fund with a contribution of US\$2 billion from the Chinese government. Sovereign guaranteed operations would be financed with US\$500 million of this amount, and non-sovereign guaranteed operations would absorb the remaining US\$1.5 billion. The Committee proposed circulating an amended document, reflecting the points discussed, for submission to the Committee of the Whole.

Proposal for a pilot partnership between the Office of Evaluation and Oversight of the Inter-American Development Bank and the Swiss Agency for Development and Cooperation. Revised version (document RE-449-1)

The Office of Evaluation and Oversight (OVE) presented a proposal to the Committee for cooperation between that office and the Swiss Agency for Development and Cooperation (SDC). The aim of the cooperation was to promote learning by SDC, the IDB, and the region in general by providing resources to be used (1) to deepen the analysis of specific aspects of certain OVE evaluations conducted under the work program approved by the Board; and (2) to strengthen the dissemination of OVE’s evaluation results.

With the support of a majority of Committee members, through a joint report of the Committee Chairpersons, the revised proposal was submitted to the Committee of the

Whole for consideration. Note was also taken of the concerns raised by several chairs and their opposition to the proposal.

Changes to existing funds

The Committee also considered proposed modifications to three existing funds: Proposal for Modification of the Special Program and Multidonor Fund for the Emerging and Sustainable Cities Initiative (document GN-2652-4); Proposal to amend Resolution DE-51/10 for the Clean Technology Fund and Resolution DE-9/11 for the Strategic Climate Fund (document GN-2674-1); and Request for authorization to sign the Amended Administration Agreement for the Regional Fund for Agricultural Technology (FONTAGRO) (document GN-1965-11).

VI. SPECIAL PROGRAMS

Proposal for the establishment of the Special Program and Multidonor Fund for Biodiversity and Ecosystem Services (document GN-2703)

The Committee considered Management's proposal for the establishment of the Special Program and Multidonor Fund for Biodiversity and Ecosystem Services. The Committee supported the proposal and agreed to submit it, as presented, to the Committee of the Whole.

Proposal for the creation of a Special Program and Multidonor Fund for Broadband Services (document GN-2704)

The Committee considered Management's proposal for the creation of the Special Program and Multidonor Fund for Broadband Services. The Committee supported the proposal and agreed to submit it, as presented, to the Committee of the Whole.

VII. FINAL THOUGHTS, CHALLENGES AHEAD, AND ACKNOWLEDGMENTS

Progress was made this year toward the objective of holding more strategic budget discussions, with less emphasis on mere approval and more on budget execution. This reflects the Committee's interest in striking a balance between the time devoted to budget preparation and to budget execution monitoring, and in transitioning from a culture of inputs and outputs to one of results- and performance-based budgeting.

Thus, monitoring budget execution twice each year was considered a good first step. The challenge remains to fine-tune the discussion of budget execution, and in particular to deepen the analysis of budget flexibility mechanisms.

The other challenge is to continue improving the format and content of the presentations of the annual Work Program and Budget. While progress has been made in this regard, the

Committee considered additional efforts important to simplify and standardize the presentations to the Board of Executive Directors in the context of the budget discussion. It will also be important to hold joint meetings with other committees to discuss the work plans and budgets of certain divisions reporting of those Committees, once and for all, so that these discussions do not need to take place again in the Budget and Financial Policies Committee.

I would also like to highlight the positive experience of holding informal meetings and technical briefings prior to formal discussion of the budget, in order to harmonize knowledge among the Executive Directors while facilitating a deeper understanding of the main issues. In my opinion, these meetings proved highly useful in preparing the Committee members for the subsequent budget discussions.

As outstanding matters I leave in the hands of my successor: first, one of the points mentioned by the previous Committee Chairperson in his final report that could not be reviewed during this period is the commitment undertaken in that term to review the new Board of Executive Directors budget execution framework, as well as the mechanisms for disseminating information on it.

Important changes in the budget cycle will occur during the next cycle, in order to simplify and shorten the cycle calendar while encouraging a more strategic discussion and striking a better balance between budget approval and execution monitoring. This pilot experience should be evaluated early next year, so that, if the results are positive, it can become a permanent feature of the institution's standard practice.

Pursuant to the Board's mandate, the Working Group on Reform of the Retirement Plans has been working on the adoption of parametric changes and structural reforms to those plans. Given the influence of those decisions on the budget and the impact on the Bank's competitiveness in attracting and retaining qualified staff, it is important to continue exploring alternatives that lend stability to the Bank's contributions to the pension plan. Nevertheless, the strong financial results of the past two years will likely allow the analytical effort to be maintained without the urgency of implementing immediate reforms.

Lastly, I want to thank Pedro Auger for his excellent work as Secretary of the Committee; Carmen Comin for her highly efficient coordination efforts, and Ward Tanner and Margarita Orozco, who prepared very detailed, accurate minutes of high quality. I would like to thank the entire Management team in the person of Yeshi Edwin, with whom we maintained very fluid and enriching exchanges, for his work and commitment in presenting high-quality documents to the Committee and encouraging open, productive discussions. Lastly, I want to thank Pablo Fliess for his invaluable support during my term, and the Committee members, who greatly facilitated my task as Chairperson with the intellectual rigor and analytical depth of all their contributions.