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FUND FOR SPECIAL OPERATIONS

PROPOSAL FOR THE ALLOCATION OF RESOURCES 2013-2014

NOVEMBER 2012

TABLE OF CONTENTS

ANNEXES

[1] (*) At request of the borrowing countries, the information contained in this Annex will not be disclosed. The non-disclosure of this document is in accordance with the "country-specific information" exception in paragraph 4.1i of the Bank's Access to Information Policy.

ABBREVIATIONS

CIPE	Country Institutional and Policy Evaluation
CPIA	Country Policy and Institutions Assessment
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
EPBA	Enhanced Performance-Based Allocation
FSO	Fund for Special Operations
IDA	International Development Association
IDB-9	Ninth General Increase in Resources of the Inter-American Development Bank
IFF	Intermediate Financing Facility
MDRI	Multilateral Debt Relief Initiative
NSG	Non-Sovereign Guaranteed Operations
OC	Ordinary Capital
PBL	Policy Based Loan
PI	Performance Index
PMR	Progress Monitoring Report
PPMR	Project Performance Monitoring Review
SGO	Sovereign Guaranteed Operations

I. INTRODUCTION

1.1 On February 21, 2007, the Board of Executive Directors (Board) approved document GN-2442 entitled "Implementation of multilateral debt relief and concessional finance reform at the IDB. Proposal for the implementation of a Debt Sustainability (DSF) and Enhanced Performance-Based Allocation (PBA) framework", which presents an enhanced performance-based allocation (EPBA) system for the distribution of Fund for Special Operations (FSO) resources, under a blended lending structure, based on the EPBA/DSF criteria. Under the DSF/EPBA, the overall allocation of concessional resources is determined by a combination of country needs and performance, which determines the FSO allocation (as per the EPBA); and the level of risk of debt distress, which defines the appropriate blend of Ordinary Capital resources (as per the DSF). As such, the DSF/EPBA links concessional resource allocation with absorption capacity, while preserving alignment with debt sustainability.

1.2 In 2010, the Board approved an update to the Country Institutional and Policy Evaluation (CIPE), one of the performance components used in the EPBA, by (i) updating the variables and the questionnaire through the harmonization with the Country Policy and Institutions Assessment (CPIA) of the World Bank, and (ii) including quantitative indicators in the assessment. The updated CIPE was implemented in the 2011-2012 allocation cycle (document GN-2442-32). Section II summarizes revisions to the CIPE applicable to the 2013-2014 allocation cycle and presents the calculation of the portfolio performance indicator, the other performance component in the EPBA.

1.3 The purpose of this document is to submit for the consideration of the Board of Executive Directors Management's proposal for the allocation of concessional resources for the 2013-2014 period according to the DSF/EPBA methodology presented in document GN-2442[2].

II. PERFORMANCE COMPONENTS OF THE ENHANCED PERFORMANCE-BASED ALLOCATION

A. Enhanced Performance-Based Allocation

2.1 The EPBA formula for FSO resources has two components: (i) **needs and economic strength**, comprised of population and Gross National Income (GNI) per capita[3]; and (ii) **country performance**, estimated as the weighted average of portfolio performance (30%) and the quality of the country's institutional and policy framework (70%), as measured by the CIPE. Each of these variables in the allocation formula has a defined exponent for the calculation of the distribution coefficient as determined in document GN-2442[4].

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[2] Information on the utilization of FSO resources allocated for the 2011-2012 cycle will be included in the 2013 report on the implementation of the DSF/EPBA framework to be presented to the Board of Governors every two years pursuant to Resolution AG-3/07.

[3] Data for population and GNI per capita is taken from the World Development Indicators.

[4] The Performance-Based Allocation (PBA) formulas for concessional resources in other Multilateral Development Banks (MDBs) also comprise the same two components although each institution has a specific weight for each variable.

B. Country Institutional and Policy Evaluation

2.2 The criteria and methodology for calculating the CIPE were originally introduced in 2002 in the context of the first proposal for a Performance Based Allocation for FSO resources (documents GN-1856-31 and CC-5819). CIPE criteria or variables are grouped into four major policy clusters, each with a specific weight in the total CIPE score: 1) Economic Management (15%); 2) Structural Policies (20%); 3) Policies for Social Inclusion/Equity (35%); and 4) Public Sector Management and Institutions (30%). The weights attached to each policy cluster were approved by the Board.

2.3 **2010 CIPE Update**. The CIPE update approved in 2010 (document GN-2442-32) had two main objectives: (i) to review and update the variables and the respective rating guide or questionnaire; and (ii) to include quantitative indicators to increase objectivity in the assessment, as recommended by OVE (documents RE-279 and RE-376). For updating the variables, and with the aim of harmonizing assessments with other MDBs, the World Bank's CPIA criteria and questionnaire were adopted as the basis for the CIPE[5], although the variables and the questionnaire associated with each were revised and adjustments were introduced to ensure that key characteristics of IDB's borrowing member countries were incorporated.[6] The CIPE update also introduced selected quantitative indicators as a component in the calculation of the overall CIPE score[7]. Specifically, the score of each variable for which there are indicators is calculated as the weighted average of i) the score stemming from the qualitative assessment, based on the questionnaire or rating guide (75%), and ii) the score implied by the quantitative indicator (25%).

2.4 **CPIA Evaluation and Revision**. In 2011 the World Bank carried out a review of the CPIA to take into consideration the recommendations of an evaluation made by the World Bank's Independent Evaluation Group (IEG) in 2010[8]. Overall, the evaluation found that the content of the CPIA broadly reflects the determinants of growth and poverty reduction identified in the economics literature, but that some criteria needed to be revised and streamlined and that one criterion related to disadvantaged socioeconomic

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[5] Since 2004 most MDBs harmonized with the CPIA. Harmonization was recommended by an Independent Panel that reviewed the CPIA and found little value added in having similar, highly correlated methodologies among MDBs. The harmonization was also consistent with the Managing for Development Results Framework (MfDR) objective of minimizing duplication in multilateral assessment approaches.

[6] For instance, when assessing health, the updated CIPE puts more weight in malnutrition issues than on AIDS and malaria policies, as in the CPIA.

[7] A total of 11 quantitative indicators for 9 of the 16 CIPE variables were introduced. Only existing, widely-used, composite quantitative indices were included considering that these indices are specifically constructed to facilitate international comparisons or to study a single country through time.

[8] The IEG made four specific recommendations: (i) disclose the ratings for IBRD countries; (ii) remove accounting for the stage of development in the rating exercise; (iii) consider not producing an overall CPIA index while continuing to produce and publish separate CPIA components; and (iv) undertake a thorough review of the adequacy of each criterion, including a review of experience and the literature, and revise as necessary, based on the findings of the evaluation. Of these, only the latter concerns the CIPE since the other three recommendations relate to features that are not applicable to the CIPE or the Bank's EPBA formula.

groups other than gender, needed to be added[9]. The review of the CPIA maintained the fundamental CPIA framework but introduced changes aimed at reducing overlap among criteria and ensuring a consistent treatment of a topic across the different rating levels of a particular criterion. As such, the revision mainly affected the detailed questionnaire or rating guide, which was fully streamlined.

2.5 **CIPE for the 2013-2014 allocation**. For the 2012 CIPE, to be applied to the 2013-2014 allocation cycle, the questionnaire was updated in accordance with the revisions to the CPIA, but all other characteristics specific to the CIPE, as described in paragraphs 2.2 and 2.3, were maintained. Additionally, and as requested by the Board in 2010, the Gender and Diversity Division of the Bank reviewed the questionnaire and indicator for the CIPE variable related to gender, indigenous and minorities inclusion issues in order to ensure consistency with the respective Bank policies. As a result of this review, the CIPE now includes a new detailed questionnaire for gender equality and for indigenous peoples and people of African descent[10], a new quantitative indicator for gender equality, and a complete list of additional information sources to guide the assessment. Given these changes, CIPE ratings from previous exercises will not be strictly comparable with the 2012 CIPE ratings. Annex IV presents the updated CIPE variables, and the selected quantitative indicators, as well as the basic procedures and rating guide to calculate the ratings for each variable and thus the overall CIPE score[11].

2.6 **Disclosure of CIPE Scores**. Traditionally, only the score of each policy cluster and total CIPE score has been disclosed as part of the allocation exercise. Considering the recommendations made by OVE, the score of all the 16 CIPE variables will be disclosed as part of the Proposal for the Allocation of Resources starting in the 2013-2014 cycle.

C. Portfolio Performance

2.7 As per document GN-1856-31, portfolio performance has been assessed on the basis of the percentage of undisbursed balances represented by projects classified as “problem” and “on alert” in the Bank’s Project Performance Monitoring Review (PPMR)[12].

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9 The CPIA has traditionally only assessed Gender Equality, but the CIPE has included, since the 2002 and through the 2010 update, an assessment related to indigenous and minorities inclusion issues.

10 For gender equality, three dimensions are assessed: (a) Reproductive health; (b) Empowerment; and (c) Labor market. In addition, and in line with the revision, the Gender Inequality Index, produced by the United Nations Development Program (UNDP), will be used as the quantitative indicator, replacing the 2010 indicator “Gender Equity Index”. For indigenous peoples and people of African descent, the assessment covers (a) Human capital development (educational attainment and access to health services); (b) Productive and economic resources (access to assets and employment); and (c) Status and protection under the law.

11 The Bank’s Research Department (RES) reviewed the methodology and provided several suggestions and recommendations for future applications of the exercise.

12 Under this approach problem projects were those operations with low or no probability of achieving their development objectives. On-alert projects are those operations classified as being on track to achieve their development objectives but that are rated as unsatisfactory or very unsatisfactory in terms of implementation progress, or that are flagged as having two or more indicators that are characteristic of projects that may become problematic in the future.

2.8 In 2009, the Bank began to implement the Progress Monitoring Report (PMR) as the new monitoring tool for operations, replacing the PPMR. Project performance in the PMR is measured by the Performance Index (PI), which uses a quantitative approach to track the achievement of a project's outputs relative to its estimated time and cost parameters. The PI is calculated once a year in March. The PI is used to classify projects as "problem", "alert" or "satisfactory".

2.9 As noted in document GN-2442-32, PMR classification for projects based on the PI will be used for the first time in the 2013-2014 allocation cycle[13]. Furthermore, and mirroring the previous methodology for the calculation of portfolio performance for the allocation of FSO resources, additional indicators that aim to assess the opportunity cost of the scarce concessional resources are considered in addition to the PI classification to determine "problem" and "on alert" projects. Specifically, the portfolio performance indicator will also measure the time elapsed from (i) approval of the loan operation until signature of the corresponding loan contract, for those countries in which ratification of loan contracts is not required, (ii) approval of the loan operation until ratification of the corresponding loan contract, for those countries in which ratification of loan contracts is required; and (iii) extensions of the final disbursement date. Projects with the respective elapsed time greater than the thresholds traditionally used to measure these indicators for the purpose of the allocation of FSO resources are considered as "on alert" or "problem". Annex V presents detailed information on the calculation of the portfolio performance indicator for the 2013-2104 allocation exercise.[14] (*)

2.10 For future allocation exercises, Management will analyze whether the thresholds traditionally used to measure said indicators need to be updated in line with improvements in project execution and the behavior of the portfolio.

III. PROPOSED ALLOCATIONS OF FSO RESOURCES FOR 2013-2014

3.1 The allocation of FSO resources for the 2013-2014 period was calculated according to the Enhanced Performance-Based Allocation formula set forth in document GN-2442 and the performance components according to the updates described in Section II. Annex I summarizes the variables and application of the EPBA for the 2013-2014 exercise.[15] (*)

3.2 **C and D1 countries**. Eligibility for FSO funding to C and D1 countries is based on a per-capita income threshold, which can be revised to reflect changes in economic conditions. Management proposes to update the eligibility threshold for FSO funding applying the

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[13] The PI could not be used for the 2011-2012 allocation cycle because its calculation required one full year of data, which was not yet available. As a result, for the 2011-2012 allocation Management used historic information similar to the PPMR methodology, in conjunction with the updated assessment of Team Leaders regarding "problem" and "on alert" projects, to calculate the performance indicator for the EPBA formula.

[14] (*) At request of the borrowing countries, the information contained in Annex V will not be disclosed. The non-disclosure of this document is in accordance with the "country-specific information" exception in paragraph 4.1i of the Bank's Access to Information Policy.

[15] (*) At request of the borrowing countries, the information contained in Annex I will not be disclosed. The non-disclosure of this document is in accordance with the "country-specific information" exception in paragraph 4.1i of the Bank's Access to Information Policy.

same criteria and methodology used in past cycles. The resulting lending eligibility threshold is calculated at $2,587 (constant 2005$)[16]. Applying such threshold yields as FSO-eligible countries Guatemala and Paraguay (both D1 countries). This entails no changes in eligibility relative to the last allocation cycle[17].

3.3 **Total annual amount of FSO Financing**. Management proposes an annual FSO allocation for the D2 countries (except Haiti) of $245.6 million and a total of $30 million for D1-eligible countries (Guatemala and Paraguay), for a grand total of $275.6 million in annual FSO financing for the 2013-2014 allocation period. This amount reflects the demand analysis and approval levels discussed in the context of the Report on the Ninth General Increase in the Resources of the Inter-American Development Bank.

3.4 **Carry-overs**. In 2011, the Board approved the elimination of the No-Carry-Over policy applicable to FSO resources within the biannual period, which allows countries to back-load or front-load resources within the allocation period in order to increase flexibility in the use of the resources (document GN-2442-34). Nonetheless, and in accordance with DSF/EPBA provisions, there will be no reallocations or carry-overs of FSO country specific allocations between allocation periods. Unused balances by the end of the biannual allocation period will be returned to the FSO pool for future allocations.

3.5 **Grant Element and Proposed Blends**. The appropriate grant element or degree of concessionality for Bolivia, Guyana, Nicaragua, and Honduras is derived from the risk of debt distress resulting from the DSF. These concessionality levels are achieved through a combination of Ordinary Capital (OC) loans and FSO loans, which have the following characteristics:

- FSO loans with a 40-year bullet repayment and a 0.25% lending rate, and
- OC loans (i.e. 3-month LIBOR based lending rate Single Currency Facility) with 30-year maturity and 5.5-year average grace period. When the outstanding disbursed amount reaches 25% of the loan amount, or $3 million, whichever the greater the amount, the rate is fixed at the then market rate.

The level of concessionality embedded in the blended structure is presented in Annex II.

3.6 The most recent DSF analysis performed for each country shows that there have been no changes in debt distress classifications relative to the last three allocation cycles under the DSF-EPBA (i.e. since 2007, after the last debt relief initiative). Annex III presents a summary of the main assumptions and results of the Debt Sustainably Analysis according to the DSF methodology performed for Bolivia, Guyana, Honduras and Nicaragua.[18] (*)

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16 The threshold was updated to account for inflation; the 2005 base year, approved in the 2009-2012 allocation cycle (Document GN-2442-16) remain unchanged

17 Eligible D1 countries are Guatemala and Paraguay with average GDP per capita in constant 2005 U.S. dollars of US$2,071 and US$1,465, respectively.

18 (*) At request of the borrowing countries, the information contained in Annex III will not be disclosed. The non-disclosure of this document is in accordance with the “country-specific information” exception in paragraph 4.1i of the Bank’s Access to Information Policy

3.7 For the 2013-2014 allocations, Management proposes to maintain the blends of FSO and OC resources approved for 2012, namely 50% of FSO and 50% of OC resources for Nicaragua and Guyana; 30% FSO and 70% OC for Honduras, and a blend of 20% FSO and 80% OC for Bolivia. For eligible D1 countries, the blend has been fixed at 20%FSO and 80%OC as per Document CA-474-2. Potential changes in the blend proportions, which require Board approval, could be proposed at any time during the biannual allocation period upon the written request of the Borrower and as long as the proposed change is consistent with the DSF.

3.8 Table 1 presents the annual allocations for 2013 and 2014 according to the DSF/EPBA.

Table 1. Proposed Annual Allocations for 2013 and 2014 (US$ millions)

	Risk of Debt Distress (DSF)	Blend		DSF-EPBA Yearly Allocations		
		FSO	OC	FSO	OC	Total
Bolivia	Low	20%	80%	71.3	285.2	356.5
Guyana	Moderate	50%	50%	14.1	14.1	28.1
Honduras	Low	30%	70%	64.5	150.5	215.0
Nicaragua	Moderate	50%	50%	95.8	95.8	191.5
Total D2				245.6	545.5	791.1
Guatemala	n/a	20%	80%	15.8	63.4	79.2
Paraguay	n/a	20%	80%	14.2	56.6	70.8
Total D1-eligible				30.0	120.0	150.0
Total Financing				275.6	665.5	941.1

IV. RECOMMENDATION

4.1 Management recommends that the Board of Executive Directors approves: (a) the Updated CIPE as presented in Section II-B; (b) the updated portfolio performance indicator as presented in Section II-C; (c) the updated eligibility threshold for C and D1 countries; and (c) the allocation of FSO and OC resources among D2 countries (excluding Haiti) and D1-eligible countries for the years 2013 and 2014, as presented in Table 1 of this document.

ANNEX II

BLENDED STRUCTURE AND LEVEL OF CONCESSIONALITY

Blended Structure		Concessionality 1/
Bullet FSO	**Standard OC**	**IMF (4.64% Base Discount rate)**
100%	0%	86.00%
75%	25%	70.23%
70%	30%	67.08%
50%	50%	54.47%
30%	70%	41.86%
25%	75%	38.71%
20%	80%	35.56%
10%	90%	29.25%
0%	100%	22.95%

1/ Assumes OC Lending Spread of 62bp.

Source: FIN, using IMF methodology.

ANNEX IV: 2012 CIPE

Policy Cluster	Variables[19]	Indicator (Source)
A. Economic management 15%	1. Monetary and Exchange Rate Policies	
	2. Fiscal Policy	
	3. Debt Policy and Management	

B. Structural policies 20%	4. Trade	The logistic performance index (World Bank)
	5. Financial Sector	Financial Market Development Index [20] (World Economic Forum)
	6. Business Regulatory Environment	Starting a Business [50%] (World Bank)
		Regulatory Quality index [50%] (Worldwide Governance Indicators)[21]
	7. Policies and institutions for environmental sustainability	Environmental sustainability index (World Economic Forum)

C. Social inclusion/equity policies 35%	8. Gender equality, indigenous peoples and people of African descent	The Gender Inequality Index (UNDP)
	9. Equity of Public Resource Use	
	10. Building human resources	Health and primary education index [75%] (World Economic Forum)
		Higher education and training index [25%] (World Economic Forum)
	11. Social Protection and Labor	

D. Public sector management and institutions 30%	12. Property rights and rule-based governance	Rule of law indicator (Worldwide Governance Indicators)
	13. Quality of budgetary and financial management	
	14. Efficiency of revenue mobilization	
	15. Quality of public administration	Government effectiveness index (Worldwide Governance Indicators)
	16. Transparency, accountability and corruption in the public sector	Control of corruption index (Worldwide Governance Indicators)

- **Basic Procedures and 2012 Questionnaire (Link)**

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19 RES provided comments regarding the methodology and the criteria to be employed in considering CIPE variables and indicators.

20 Previously called "The Financial Market Sophistication Index".

21 The Worldwide Governance Indicators are produced by Kaufmann, Kraay and Mastruzzi