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REVIEW OF THE IMPLEMENTATION OF THE DEBT SUSTAINABILITY FRAMEWORK AND ENHANCED PERFORMANCE-BASED ALLOCATION 2015-2016

MARCH 2017

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ABBREVIATIONS

CDB	Caribbean Development Bank
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
GCI-9	Ninth General Increase in Resources of the Inter-American Development Bank
GDP	Gross Domestic Product
GNI	Gross National Income
IDA	International Development Association
IMF	International Monetary Fund
MDB	Multilateral Development Bank
MDRI	Multilateral Debt Relief Initiative
MFI	Multilateral financial institution
NSG	Non-Sovereign Guaranteed Operations
OC	Ordinary Capital
OECD	Organization for Economic Cooperation and Development
OVE	Office of Evaluation and Oversight
PBA	Performance-Based Allocation
PBL	Policy-Based Loan
PMR	Progress Monitoring Report
PPMR	Project Performance Monitoring Review
PTI	Poverty Targeted Investment
RES	Research Department
SCF	Single Currency Facility
SEQ	Social Equity
SG	Sovereign Guaranteed
SI	Synthetic Indicator
SPD	Office of Strategic Planning and Development Effectiveness
ULB	Undisbursed Loan Balances
WB	World Bank

I. INTRODUCTION

A. Objective

1.1 On March 15, 2007, the Board of Governors approved Resolution AG-03/07, which states that every two years there shall be a review of implementation of the Debt Sustainability Framework and Enhanced Performance-Based Allocation (DSF/EPBA). Management has presented four reviews for the consideration of the Board of Executive Directors (Board) and subsequent distribution to the Board of Governors for information at the IDB Annual Meeting: (i) in 2009 (Documents GN-2442-17 and AB-2646); (ii) in 2011 (Documents GN-2442-34 and AB-2646-1); (iii) in 2013 (Documents GN-2442-44 and AB-2646-2); and (iv) in 2015 (Documents GN-2442-48 and AB-2646-3).

1.2 The purpose of this document is to submit for the consideration of the Board Management's fifth review of the implementation of the DSF/EPBA framework. Management also requests that the Board authorize transmission of this report for information to the Board of Governors. This fifth review takes place one decade after the IDB approved multilateral debt relief for Bolivia, Guyana, Honduras and Nicaragua and introduced the DSF/EPBA framework.

B. The Debt Sustainability Framework and Enhanced Performance-Based Allocation

1.3 On February 21, 2007, the Board approved document GN-2442 "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 presented an enhanced performance-based allocation (EPBA) system for the distribution of Fund for Special Operations (FSO) resources, under a structure that blends FSO and OC resources (blended structure), based on the DSF/EPBA criteria.[1] Total allocation of concessional resources under the DSF/EPBA is determined by a combination of country needs and performance, which determines the allocation of FSO resources (first step); and the risk of debt distress, which defines the appropriate blend of Ordinary Capital (OC) resources (second step). The DSF/EPBA aims to ensure a link between concessional resource allocation and absorption capacity, while preserving debt sustainability.

1.4 The EPBA for FSO resources has two major elements: (i) **needs and economic strength**, comprised of population and Gross National Income (GNI) per capita;[2] and (ii) **performance**, estimated as the weighted average of portfolio performance (30%) and the quality of the institutional and policy framework (70%), as measured by the Country Institutional and Policy Evaluation (CIPE). Each of these variables in the allocation

[1] "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 (EPBA) framework" (GN-2442).

[2] Data for population and GNI per capita is taken from the World Development Indicators (World Bank).

formula has a defined exponent for the calculation of the distribution coefficient as determined in document GN-2442.[3]

1.5 The DSF defines the risk of debt distress (low, moderate, high or in debt distress), which in turn determines the appropriate level of concessionality for each country through the blended structure.

II. CONCESSIONAL ALLOCATIONS IN 2015-2016

A. Concessional allocations under the EPBA/DSF in 2015-2016

2.1 Four countries (Bolivia, Guyana, Honduras and Nicaragua) [FSO-IV] were eligible for a concessional finance allocation under the EPBA/DSF for 2015 and 2016.[4] Based on the per capita income threshold (US$2,579 at 2009 prices), no C and D1 countries were eligible for the 2015-2016 allocation.[5] A total of US$277.6 million in FSO resources per year was allocated among the FSO-IV countries, according to the EPBA framework (Table 1).

Table 1. Annual allocations to eligible countries, 2015-2016 (US$ million)

	(1) EFBA allocation	(2) DSF	Blend			(3) = (1) + (2)
	FSO	Risk of Debt Distress	FSO	OC	OC	Yearly allocation
Bolivia (2015)	95.0	Low	20%	80%	380.0	475.0
Bolivia (2016)	95.0	Low	15%	85%	538.4	633.4
Guyana	14.3	Moderate	50%	50%	14.3	28.6
Honduras	68.0	Moderate	40%	60%	102.0	170.0
Nicaragua	100.3	Moderate	40%	60%	150.4	250.7
Total Financing 2015	277.6				646.7	924.3
Total Financing 2016	277.6				805.1	1,082.7

Source: GN-2442-46.

2.2 Following the DSF, the blend of FSO and OC resources changed for three of the countries, with respect to the 2013-2014 allocation. The FSO/OC blend applicable to

[3] $(POP^{0.5} \times GNIpc^{-1} \times [0.7*CIPE + 0.3\ PPI]^2)$. The performance-based allocation formulas for concessional resources in other multilateral development banks (MDBs) also comprise the same two components although variable weights and exponents vary.

[4] Per the "Report on the Ninth General Increase in Resources of the Inter-American Development Bank" (AB-2764), Haiti is outside the EPBA/DSF framework until 2021 and receives support in the form of grants only.

[5] Since the estimated per capita GDP (average 2012-2013) for Guatemala and Paraguay exceeded the per-capita income threshold, these countries were determined ineligible for FSO lending during the 2015-2016 FSO allocation period (GN-2446-46).

Bolivia remained at 20% FSO/80% OC for 2015 but changed to 15% FSO/85% OC in 2016. The FSO/OC blend applicable to Honduras changed from 30% FSO/70% OC in 2013-2014 to 40%/60% for 2015-2016, while that for Nicaragua changed from 50% FSO/50% OC in 2013-2014 to 40% FSO/60% OC for 2015-2016. The FSO/OC blend applicable to Guyana was unchanged at 50% FSO/50% OC.

B. EPBA/DSF approvals in 2015-2016

2.3 A total of 36 operations with blended resources amounting to US$1,942 billion were approved during 2015-2016, of which US$529.2 million corresponded to FSO resources (Table 2). For the two years, investment loans accounted for 73% of the loan resources and policy-based loans (PBLs) for 27%.

Table 2. Operations Approved by Country, 2015-2016 (US$ million)

	2015			2016			2015-2016
	FSO	**OC**	**Total**	**FSO**	**OC**	**Total**	**Total**
Bolivia	**95.0**	**380.1**	**475.1**	**95.0**	**538.4**	**633.4**	**1,108.5**
Investment	66.5	266.1	332.6	66.5	376.9	443.4	776.0
PBL	28.5	114.0	142.5	28.5	161.5	190.0	332.5
Guyana	**8.6**	**8.6**	**17.2**	**20.0**	**20.0**	**40.0**	**57.2**
Investment	0.0	0.0	0.0	20.0	20.0	40.0	40.0
PBL	8.6	8.6	17.2	0.0	0.0	0.0	17.2
Honduras	**68.0**	**102.0**	**170.0**	**68.0**	**102.0**	**170.0**	**340.0**
Investment	28.0	42.0	70.0	68.0	102.0	170.0	240.0
PBL	40.0	60.0	100.0	0.0	0.0	0.0	100.0
Nicaragua	**110.3**	**165.4**	**275.7**	**64.3**	**96.4**	**160.7**	**436.4**
Investment	84.3	126.4	210.7	64.3	96.4	160.7	371.4
PBL	26.0	39.0	65.0	0.0	0.0	0.0	65.0
Grand Total	**281.9**	**656.1**	**938.0**	**247.3**	**756.8**	**1,004.1**	**1,942.1**
Investment	178.8	434.5	613.3	218.8	595.3	814.1	1,427.4
PBL	103.1	221.6	324.7	28.5	161.5	190.0	514.7
PBL as % total	37%	34%	35%	12%	21%	19%	27%

*Excludes NSG operations and operations funded exclusively with OC resources. GLM operations are detailed below.
Source: VPC based on IDB's OPS Analyzer.

2.4 In terms of sector distribution, on a biennial basis, by value 81% of operations approved for 2015-2016 were in the Infrastructure and Environment sector (Table 3). This compares with 47% of total approved loan value during 2013-2014 and 41% during 2011-2012. In 2015-2016, 11% of total approvals were in the Institutions for Development sector and 8% were in the Social Sector.

Table 3. Operations Approved by Sector, 2015-2016 (US$ million)

	2015-2016		
	Sector		
	*Inst. for Development	**Infrastructure & Environment	Social Sector
Bolivia	0.0	1,068.5	40.0
Guyana	17.0	32.2	8.0
Honduras	87.0	183.0	70.0
Nicaragua	105.0	286.4	45.0
Total	**209.0**	**1,570.1**	**163.0**
% total	10.8%	80.8%	8.4%

*Includes Trade and Integration.
** Includes CSD.
Source: VPC based on IDB Quarterly Business Review, September 2016.

C. Grant Leverage Mechanism[6]

2.5 In September 2013, the Board of Governors approved a proposal to establish a Grant Leverage Mechanism (GLM) with the purpose of leveraging grant resources from bilateral and multilateral donors with resources from the OC to finance investment operations in shared priority areas, thereby increasing the concessional resources available for the eligible countries (Bolivia, Guyana, Honduras and Nicaragua). The GLM was a pilot mechanism with a duration of 3 years from the date of approval by the Board of Governors, i.e., from September 13, 2013 to September 13, 2016. The GLM was established with a maximum amount of US$100 million of OC resources.

2.6 The GLM was not part of the EPBA, because, by design, an external grant replaced the EPBA-concessional portion of the financing blend. However, the GLM was subject to the DSF. In order to provide a level of concessionality consistent with the countries' debt sustainability, the lending blends of the GLM followed the blends established in biennial allocation proposals, under the EPBA/DSF. Moreover, GLM-debt financing has been incorporated in countries' debt sustainability analyses, since it is in addition to the countries' regular EPBA/DSF allocations.

2.7 In the three years of GLM execution, four projects in three countries were approved using the GLM. Consistent with the respective countries' country strategies, all four operations were in the energy and water and sanitation sectors.[7] The four projects utilized fully the US$100 million of OC-financing approved for the GLM (Table 4). The US$100 million of OC-financing "crowded in" US$67 million of grant funding and a further $25 million of non-IDB concessional financing.

[6] "Grant Leverage Mechanism: A Proposal" (AB-2946).

[7] IDB Country Strategy with Bolivia (2016-2020) [GN-2843]; IDB Country Strategy with Guyana (2012-2016) [GN-2690]; IDB Country Strategy with Nicaragua (2012-2017) [GN-2683].

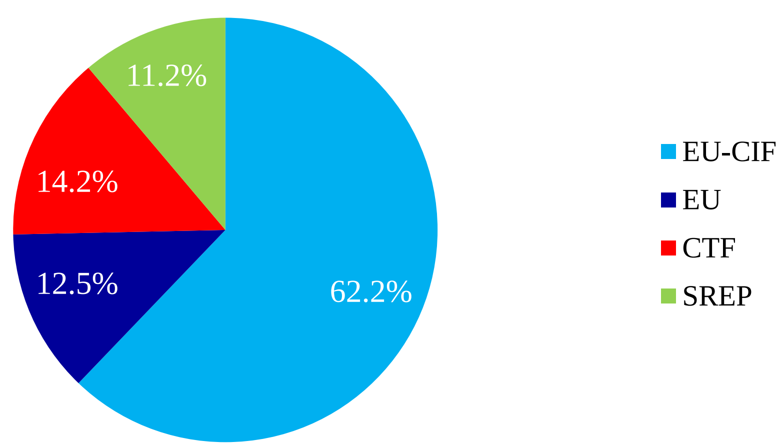
Table 4. Approvals under the GLM

Country	Loan	Sector	Approval date	GLM		IDB allocation funding (US$ million)	Other non-IDB funding (US$ million)	Project total (US$ million)
				Grant amount (US$ million)	OC amount (US$ million)			
Guyana	GY-L1041	Energy	25-Jun-14	22.50	22.50	15.14	4.43	64.57
Guyana	GY-L1040	Water and Sanitation	3-Jul-14	7.50	7.50	9.34	7.34	31.68
Bolivia	BO-L1118	Water and Sanitation	9-Sep-16	8.40	47.33	30.00	0.00	85.73
Nicaragua	NI-L1094	Energy	9-Sep-16	17.02	22.67	28.70	25.00	93.39
TOTAL				**55.42**	**100.00**	**83.18**	**36.77**	**275.37**
Financing shares				**20.1%**	**36.3%**	**30.2%**	**13.4%**	**100.0%**

Source: Project documents for GY-L1041, GY-L1040, BO-L118, and NI-L1094.

2.8 The *European Union (EU)* either directly or indirectly, through its *Caribbean Investment Facility (CIF)*, provided the grant component for three of the four projects. The EU also provided three-quarters of the grant financing in monetary terms (Figure 1). The *Clean Technology Funds (CTF)* provided 14% of the grant funding and the *Scaling Up Renewable Energy Program (SREP)* provided 11%.

Figure 1. Source of GLM grants



Source: Project documents for GY-L1041, GY-L1040, BO-L118, and NI-L1094.

2.9 As required by "Grant Leverage Mechanism: A Proposal" (AB-2946), financing blends of GLM projects followed those approved by the Board of Executive Directors in biennial allocation proposals. As a result, the weighted-average concessionality of the total financing packages for the four GLM projects exceeded the corresponding Board-approved concessionality benchmarks (Table 5).[8]

Table 5. Concessionality under the GLM

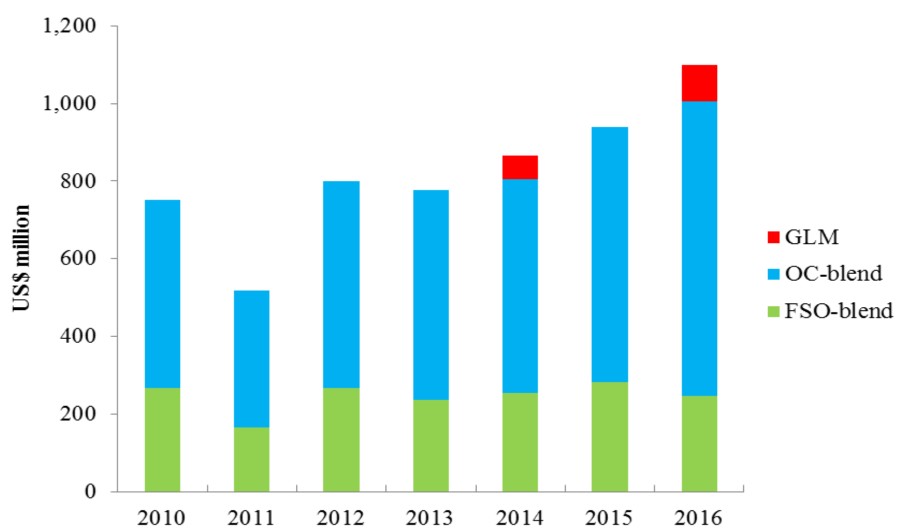
Country	Loan	Sector	Approval date	Weighted-average concessionality (%)	Board-approved benchmark concessionality (%)	Source of Board benchmark concessionality
Guyana	GY-L1041	Energy	25-Jun-14	62.5%	54.5%	GN-2442-42
Guyana	GY-L1040	Water and Sanitation	3-Jul-14	68.3%	54.5%	GN-2442-42
Bolivia	BO-L1118	Water and Sanitation	9-Sep-16	26.3%	24.4%	GN-2442-46
Nicaragua	NI-L1094	Energy	9-Sep-16	47.5%	41.2%	GN-2442-46

Source: GN-2442-42, GN-2442-46, project documents and IMF Concessionality Calculator http://www.imf.org/external/np/pdr/conc/calculator/default.aspx.

Note: The estimated concessionality for OC and FSO portions of the financing packages was taken from the concessionality estimated in the respective biennial allocation proposals (GN-2442-42 for loans approved in 2014 and GN-2442-46 for loans approved in 2016).

2.10 The GLM has not had a significant impact in increasing countries' debt burdens. GLM approvals in 2014 added 3.8% of funding to the 2013-2014 EPBA/DSF allocation of FSO and OC resources to the FSO-IV countries and GLM approvals in 2016 added 4.1% to the 2015-2016 EPBA/DSF allocation (Figure 2).

Figure 2. FSO IV EPBA/DSF + GLM Approvals



Source: AB-2646-3; GN-2442-45.

[8] As noted in AB-2946, since grants have a grant element of 100% whereas FSO loans had a concessionality of 81-84%, a GLM project would have a slightly higher concessionality than a FSO/OC blended loan with the same blending proportion. The difference in concessionality would be larger the higher the proportion of FSO/grant funding in the blend.

2.11 The financing context has evolved since the time when the GLM was proposed and approved. On the supply side, regular EPBA/DSF allocations to the concessional-eligible countries have expanded significantly since 2013. The total annual average allocation for 2013-2014 was US$791 million compared with US$1,162 million for 2017-2018. On the absorption-side, both the apparent turn in debt sustainability in 2013-2014 (see Section V.) as well as a slight reversal in portfolio implementation performance since 2011-2013 (Section IV.) may indicate that the capacity for absorption of extra resources is less clear cut than in 2013.

III. CONCESSIONALITY PROVIDED

A. Concessionality

3.1 The risk of debt distress under the DSF determines the appropriate degree of concessionality for each country. As GN-2442 noted, "concessionality levels will vary over time depending on changes in interest rates, discount rates and other relevant factors." The key driver of concessionality or grant element is the difference between the interest rate charged for a loan and the discount rate. Since the EPBA/DSF framework was introduced, the discount rate used to estimate concessionality has declined from 7.18% to 5.0% (Table 6). This has reduced the differential between the discount rate and the FSO lending rate (fixed at 0.25%). By contrast, the differential between the discount rate and the assumed OC lending rate has been broadly stable since the introduction of the EPBA/DSF because the same trends in market interest rates that led to a decline in the discount rate were also associated with a decline in the assumed OC lending rate. Notwithstanding the trends in the differentials with the discount rates, even by 2017, the differential between the discount rate and the FSO lending rate was more than three percentage points greater than that of the OC portion, and the FSO was the main conduit for providing concessionality to the concessional-eligible countries.

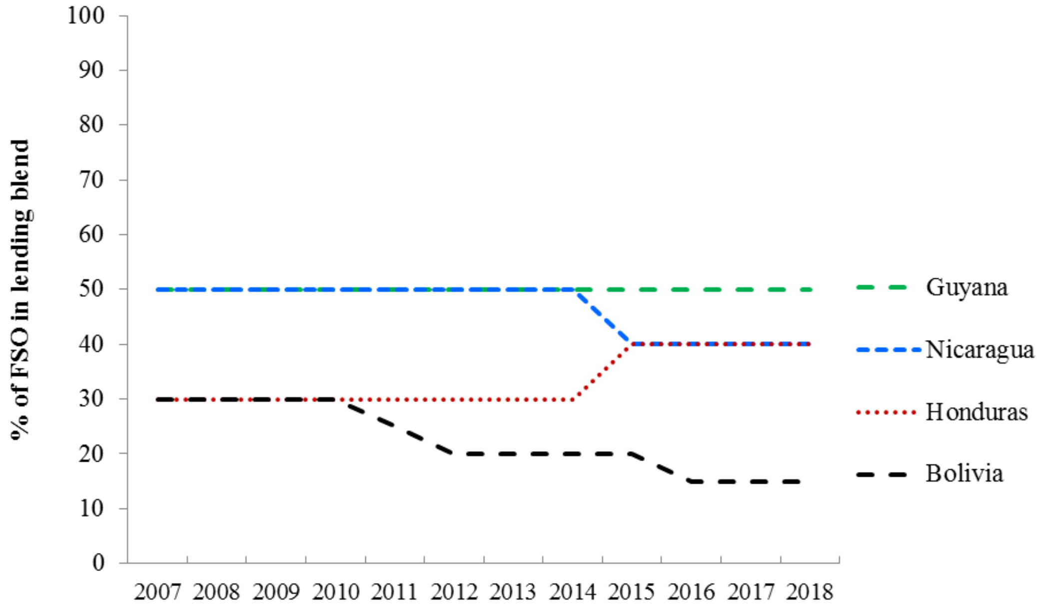
Table 6. Discount rates and assumed interest rates, 2008-2018

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Discount rate	7.18	6.80	6.80	5.27	5.27	4.64	4.64	5.00	5.00	5.00	5.00
Assumed OC interest rate	5.50	5.56	5.56	4.18	4.18	2.66	2.66	3.74	3.74	3.50	3.50
Discount-OC differential	***1.68***	***1.24***	***1.24***	***1.10***	***1.10***	***1.98***	***1.98***	***1.26***	***1.26***	***1.50***	***1.50***
FSO interest rate	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Discount-FSO differential	***6.93***	***6.55***	***6.55***	***5.02***	***5.02***	***4.39***	***4.39***	***4.75***	***4.75***	***4.75***	***4.75***

Source: GN-2442, GN-2442-16, GN-2442-32, GN-2442-42, GN-2442-46, GN-2442-53; Discount rates from IMF concessionality calculator, which in turn were historically based on a 10-year moving average of long-term commercial interest reference rates provided by the OECD. For the purpose of concessionality calculations, IDB allocation documents have used fixed-interest rate base costs for the OC portions of blended loans.

3.2 GN-2442 further stated that "Management will adjust the blend structure of the parallel loan to grant the appropriate level of concessionality required by the macroeconomic program in line with the DSF Approach". Management has followed this approach in successive allocation proposals (Figure 3).

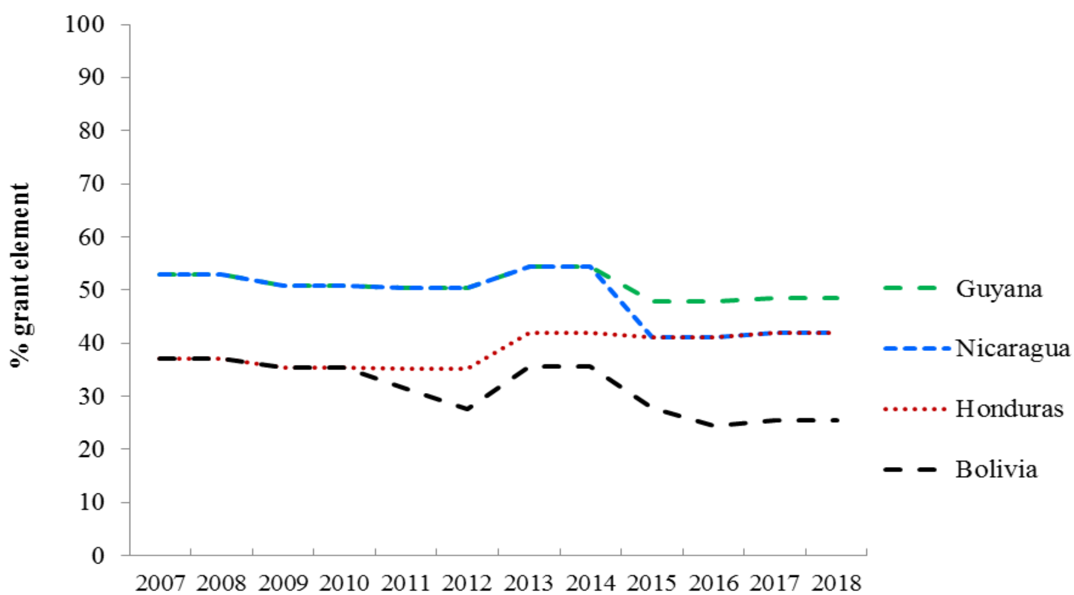
Figure 3. Proportion of FSO in lending blend



Source: GN-2442, GN-2442-16, GN-2442-32, GN-2442-42, GN-2442-46, GN-2442-53.

3.3 Adjustments in the blending proportions were the predominant influence on the level of concessionality provided, with changes in concessionality largely mirroring changes in approved lending blends (Figures 3 and 4). However, changes in discount rates and assumed interest rates on the OC portion of blended loans caused year-to-year variations in concessionality. Moreover, the decline of the discount rate from 2008 to 2015 led to a small erosion in the level of concessionality provided for any given blending proportion.

Figure 4. Concessionality provided



Source: GN-2442, GN-2442-16, GN-2442-32, GN-2442-42, GN-2442-46, GN-2442-53.

3.4 The concessionality that the IDB provided to each country was broadly comparable with that of other official creditors (Annex III).

IV. REVIEW OF THE ENHANCED PERFORMANCE-BASED ALLOCATION (EPBA)

A. Country Institutional and Policy Evaluation (CIPE)

4.1 The CIPE assesses the quality of a country's present policy and institutional framework. CIPE criteria or variables are grouped into four major policy clusters, each with a specific weight in the total CIPE score: (i) Economic Management (15%); (ii) Structural Policies (20%); (iii) Policies for Social Inclusion/Equity (35%); and (iv) Public Sector Management and Institutions (30%). The weights attached to each policy cluster were approved by the Board.

4.2 The CIPE was reformed in 2010 (document GN-2442-32) and 2012 (GN-2442-42) in order: (i) to update the variables and the respective rating guide; (ii) to include quantitative indicators to increase objectivity in the assessment, as recommended by OVE (documents RE-279 and RE-376); and (iii) to harmonize methodologies with other MDBs.[9] Eleven of the 16 CIPE variables have quantitative indicators, which account for 25% weight of the respective variables. Overall, the quantitative indicators have a weight of approximately 15% of the overall CIPE rating. In practice, countries' overall CIPE scores with and without the quantitative indicators have been similar, indicating that the incorporation of the quantitative indicators has not significantly changed overall CIPE ratings.

4.3 The CIPE variables and weights have not changed since 2012. Consequently, the same CIPE variables and weights were applied for the 2012, 2014 and 2016 CIPEs. Although revisions/updates to the CIPE in 2010 and 2012 complicate comparisons with earlier years, at the aggregate level, CIPE scores have maintained a broadly similar level from 2006 through 2016 (Figure 5). Notably, the average ratings for the social inclusion and public sector management clusters have remained stable from 2012-2016. By contrast, average CIPE scores for the Economic Management policy cluster declined from 2012 to 2014 and again in 2016. This decline reflects in part less favorable economic outcomes, likely as a result of declining commodity prices in that period.[10] Nevertheless, the Economic Management policy cluster remains the cluster with the highest scores. Annex I presents the evolution of total CIPE scores by country and Annex II presents detailed information on the 2016 CIPE.

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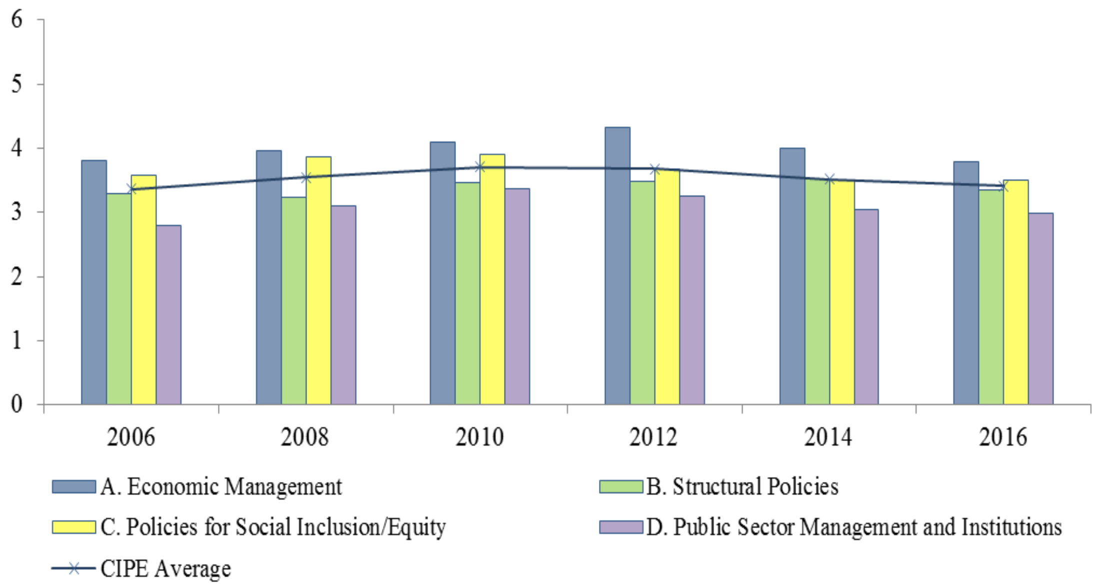
[9] Since 2004 most MDBs harmonized with the World Bank's Country Policy and Institutions Assessment (CPIA). Harmonization was recommended by an Independent Panel that reviewed the CPIA and found little value added in having similar, highly correlated methodologies among MDBs. Harmonization was also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

[10] Notwithstanding that the CIPE tries to measure the quality of policies, inevitably to some degree it captures outcomes, particularly through the quantitative indicator components. Economic outcomes in 2014 and especially 2016 were generally less favorable than in 2012.

Figure 5. Average CIPE Ratings for FSO-IV Countries



Sources: VPC based on GN-2442-53, GN-2442-46, GN-2442-41, GN-2442-32, GN-2442-16, GN-2442.

B. Portfolio Performance

4.4 Under the EPBA framework, and consistent with GN-2442, portfolio performance has been assessed as the percentage of undisbursed loan balances (ULB) represented by projects classified as "problem" and "on alert". For the 2015-2016 allocation, the portfolio performance indicator was modified to incorporate the methodological changes introduced to the classification of projects in the Bank's updated Progress Monitoring Report (PMR).[11] Additionally, since time-elapsed indicators in the PMR are measured against an intra-country historical benchmark, for the purposes of the 2015-2016 allocation, projects were also evaluated by comparing them against Bank-wide benchmarks, in order to measure for relative performance among countries (Document GN-2442-46).[12] The same methodology for calculating the Portfolio Performance Indicator (PPI) was used for the 2017-2018 allocation.

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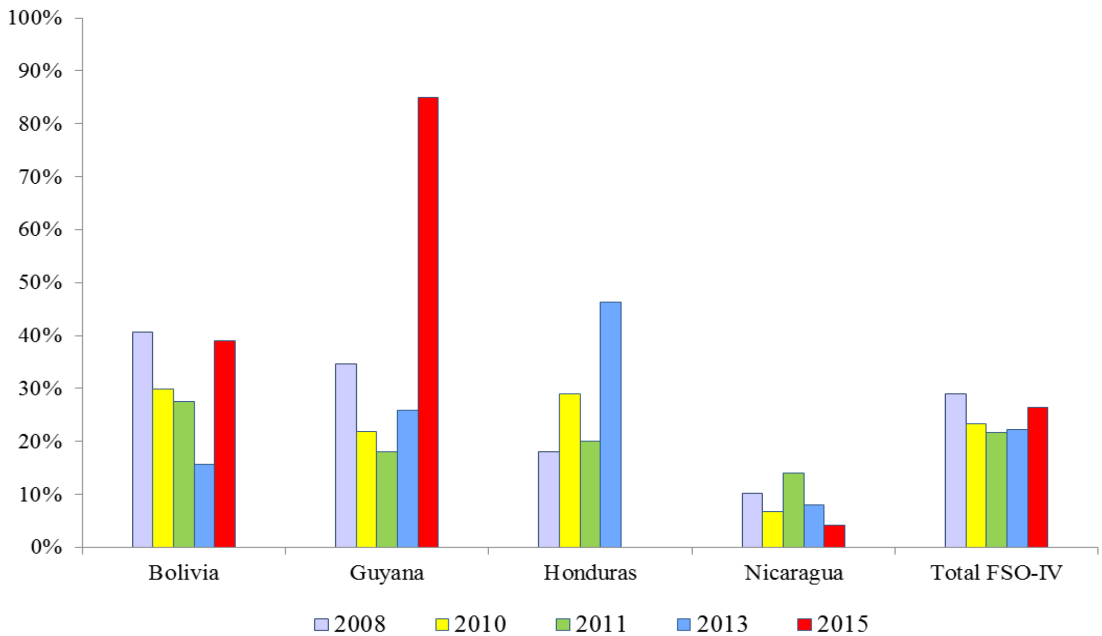
[11] As part of the recent GCI-9 evaluation (RE-425-4), OVE reviewed the PMR methodology and found that, among other things, having the PI as the only indicator to determine project classification was limited and could create false positive cases. In view of this and other lessons learned, a review to the PMR and the respective proposal for adjustments was approved in December 2013 (OP-1072-1). The new PMR captures different dimensions of projects' performance. Different indicators are measured at each stage of the project's life cycle, that is: (i) after Board approval and before reaching eligibility; (ii) between eligibility and up to 95% disbursement; and (iii) between 95% disbursement and project closure. A synthetic indicator (SI), reflecting a weighted average of the indicators used for rating the project's execution performance, serves as the basis of the project classification after the projects become eligible for disbursements.

[12] These indicators 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; (iii) legal effectiveness to eligibility; and (iv) extensions of the final disbursement date.

4.5 At the aggregate level for the FSO-IV countries, portfolio performance deteriorated modestly between 2013 and 2015 (it improved in two countries and deteriorated in the other two). The share of undisbursed loan balances in “Unsatisfactory” projects (those “on alert” or with “problem” status) increased from 22.2% of total ULB at December 31, 2013 to 26.4% by December 31, 2015 (Figure 6). Nevertheless, this proportion remained below the level recorded in 2008 (28.9%).

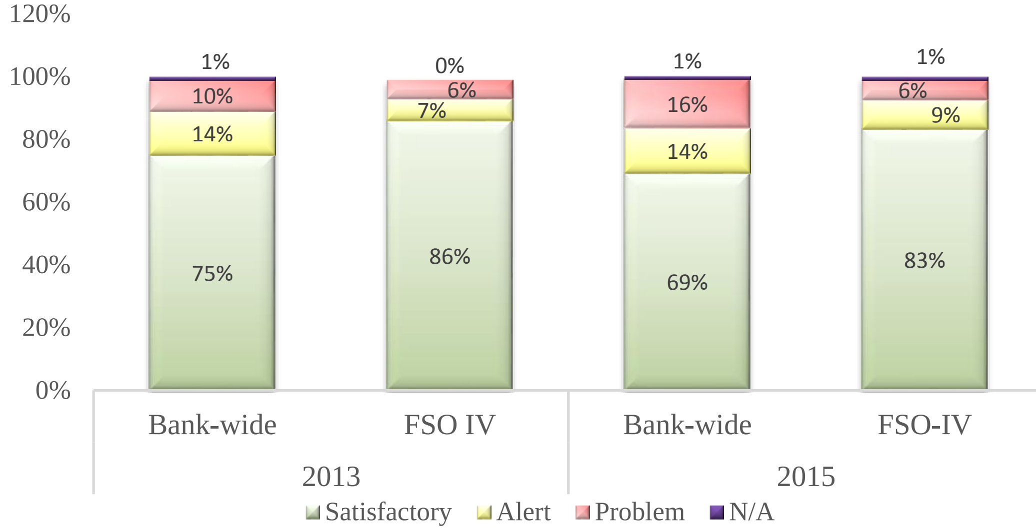
Figure 6. “Unsatisfactory” Project Classification for the EPBA (as % of ULB)



Source: VPC based on GN-2442-53, GN-2442-46, GN-2442-41, GN-2442-32, GN-2442-16, GN-2442.
Note: No column appears for Honduras in 2015 because the unsatisfactory ULB was 0%. In 2015, a new governing party took office in Guyana after 23 years in opposition, which led to staff changes and a prolonged review of investment priorities.

4.6 PMR classifications show a similar small deterioration in the portfolio performance in the FSO-IV countries between end-2013 and end-2015. The share of the number of projects with a satisfactory PMR decreased from 86% in 2013 to 83% in 2015 (Figure 7). Nevertheless, the satisfactory PMR share of the FSO-IV countries (four of the five lowest-income borrowing member countries) remained superior to the Bank average.

Figure 7. Project Classification per the SI in 2013 and 2015



Sources: Progress Monitoring Reports for 2013 and 2016.

V. REVIEW OF THE DEBT SUSTAINABILITY FRAMEWORK (DSF)

A. Outstanding Debt to the IDB

5.1 On March 15, 2007, the Board of Governors approved the Multilateral Debt Relief and Concessional Finance Reform (CA-474-2), which included 100% debt relief for Bolivia, Guyana, Haiti, Honduras and Nicaragua on FSO loan balances outstanding as of December 31, 2004 and effective on January 1, 2007. This debt relief covered both the Bank's participation in the Enhanced HIPC Initiative as well the IDB's equivalent of the Multilateral Debt Reduction Initiative (MDRI) (Table 7).[13]

Table 7. IDB FSO-IV 2006/2007 Debt Relief

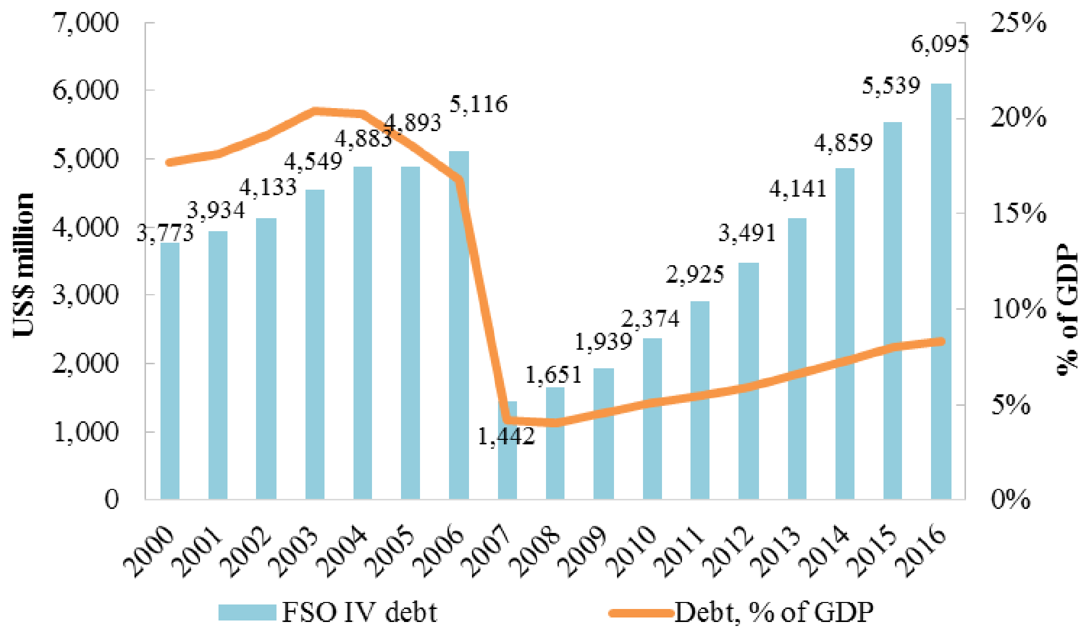
Country	Enhanced HIPC (US$ million)	IDB 2007 (MDRI) (US$ million)	Total (US$ million)
Bolivia	430.3	741.0	1,171.3
Guyana	55.2	356.5	411.7
Honduras	73.3	1,070.5	1,143.8
Nicaragua	382.5	790.1	1,172.6
TOTAL	**941.3**	**2,958.2**	**3,899.5**

Source: FIN.

[13] In June 2005, the Group of 8 major industrial countries proposed that three multilateral institutions—the IMF, the International Development Association (of the World Bank Group), and the African Development Fund (of the African Development Bank)—cancel 100% of their debt claims on countries eligible for full and irrevocable debt relief under the joint IMF-World Bank enhanced Initiative for Heavily-Indebted Poor Countries. IMF MDRI-relief covered the full stock of debt owed to the IMF at the end of 2004.

5.2 After a sharp reduction associated with debt relief in 2007, SG debt to the IDB grew rapidly in nominal terms, from US$1.4 billion in 2007 to US$6.1 billion 2016 (Figure 8). In nominal terms, SG debt to the IDB was 20% larger in 2016 than one decade earlier. However, as a proportion of GDP, by 2016 IDB debt was equivalent to 8% of the FSO-IV countries' combined GDP, which was less than half the level of the years preceding debt relief.

Figure 8. Outstanding FSO-IV sovereign-guaranteed debt to the IDB



Source: VPC based on Annex IV.

B. Debt Sustainability as Measured by the DSF

5.3 Since the introduction of the EPBA/DSF, the IDB has produced five sets of DSAs under the DSF for the biennial allocation proposals in 2008, 2010, 2012, 2014 and 2016. Comparison of the DSAs over time, particularly at the level of individual countries, is somewhat affected by exogenous shocks, such as: (i) the IMF's reductions in the LIC-DSF discount rate from 5% to 4% in 2010 and then to 3% in September 2012, followed by an increase from 3% to 5% in September 2013;[14] (ii) the upward revision in the estimated size of Guyana's GDP in 2009 (used for DSAs from 2010 onwards);[15] and (iii) the upward revision in the estimated size of Nicaragua's GDP in 2012 (used for DSAs

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[14] A decrease in the discount rate raises the present value of debt and debt service (increasing the perceived risk of debt distress), while an increase in the discount rate reduces the present value of debt and debt service (decreasing the perceived risk of debt distress.

[15] Guyana's GDP data were rebased from 1988 to 2006, with the result that 2009 GDP at market prices was 64% higher than previously estimated (IMF Staff Report for the 2009 Article IV Consultation, Country Report No. 10/292, September 2010).

from 2012 onwards).[16] Nevertheless, a number of conclusions can be drawn regarding the DSAs of the FSO-IV countries as a group (Figures 9 and 10)[17]:

i. Comparing the last DSA prior to IDB debt relief (2006) with subsequent DSAs shows that implementation of IDB debt relief to the FSO-IV countries at the end of 2006 led to a significant and immediate improvement in debt sustainability from a solvency (stock-of-debt) perspective. The present value (PV) of external public and publicly-guaranteed debt-to-GDP ratio declined from almost 40% of GDP to 22%. The external debt service-to-exports ratio declined over the medium term. These findings are broadly consistent with other reviews.[18]

ii. The improvement in solvency was sustained through 2016; the situation with the debt service burden indicator is more ambiguous.

iii. Successive projections of debt burden indicators over the medium and long term have not pointed to a deterioration in debt sustainability;

iv. Comparison of the actual track of debt burden indicators with DSA projections reveals no systematic bias in either over- or under-projecting future debt burden indicators.

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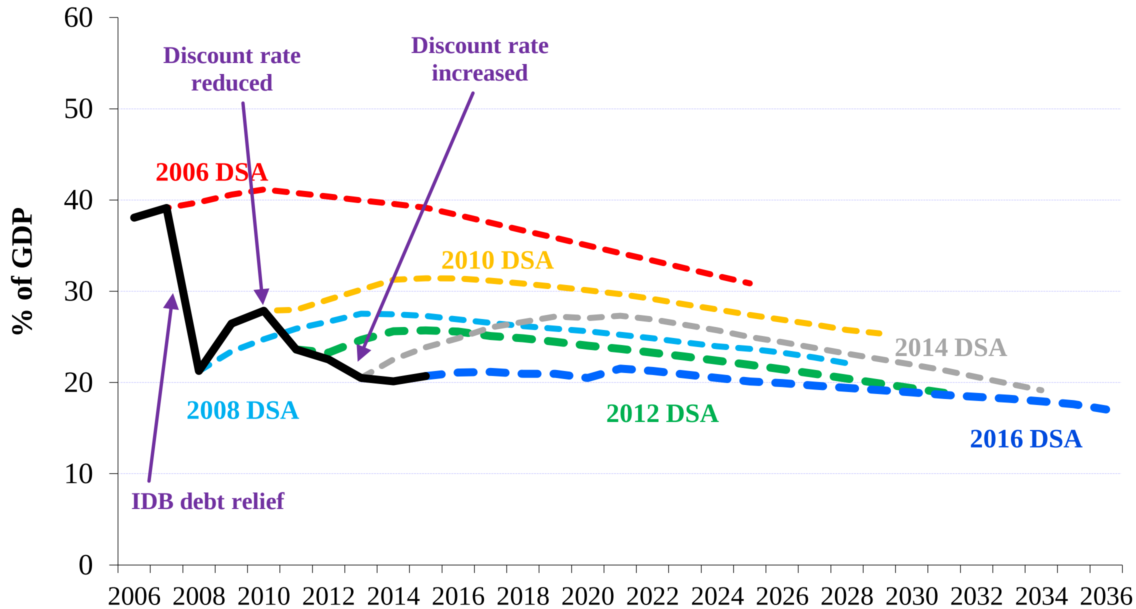
[16] In 2012, Nicaragua's national accounts were rebased from a reference year of 1994 to 2006, which resulted in an increase of 27% in the estimated size of GDP in 2012.

[17] The LIC DSF uses three solvency and two liquidity debt burden indicators ("Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries", IMF, November 2013). For reasons of space, only one solvency indicator and one liquidity indicator are presented. The other three debt burden indicators are: (i) the present value of public and publicly-guaranteed external debt to exports of goods and service; (ii) the present value of public and publicly-guaranteed external debt to fiscal revenue; and (iii) public and publicly-guaranteed external debt service to fiscal revenue.

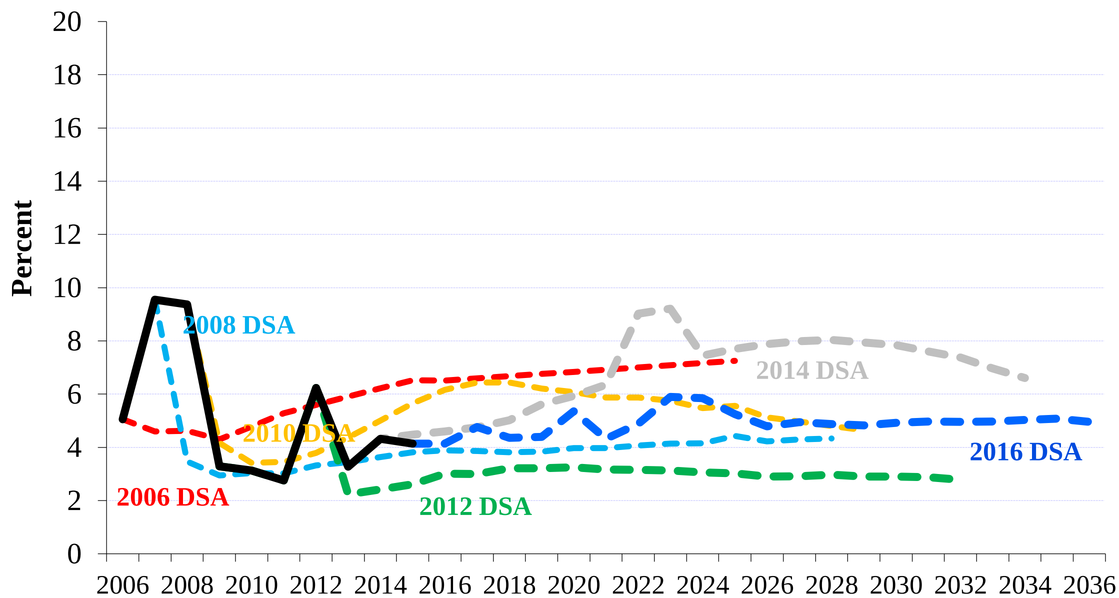
[18] IMF "Public Debt Vulnerabilities in Low-Income Countries: The Evolving Landscape", November 2015; Baduel, B. and R. Price (2012) "Evolution of Debt Sustainability Analysis in Low-Income Countries: Some Aggregate Evidence", IMF Working Paper (WP/12/167) Washington, D.C.; Prizzon, A. and S. Mustapha (2014) "Debt sustainability in HIPCs in a new age of choice", ODI Working Paper 397, London, U.K.

Figure 9. FSO-IV SIMPLE AVERAGE: The Evolution of Baseline Projections of Present Value of Public and Publicly-Guaranteed External Debt-to-GDP Ratio



Source: DSA Excel files prepared for biennial allocation proposals in 2008, 2010, 2012, 2014 and 2016; 2006 from IMF staff reports (Annex V). Baseline projection in Graph "b" of standard DSF DSA charts.

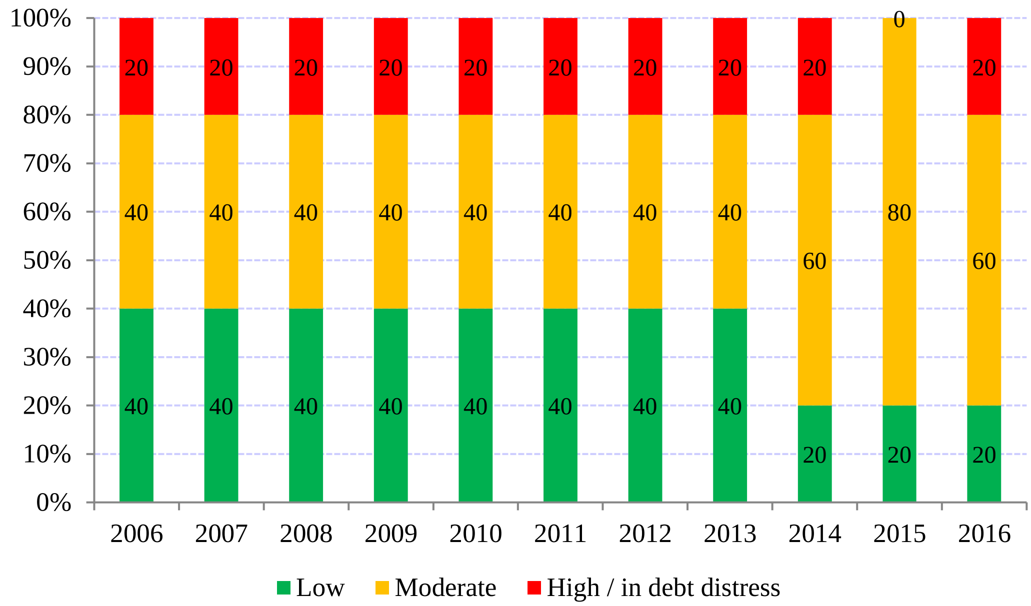
Figure 10. FSO-IV SIMPLE AVERAGE: The Evolution of Baseline Projections of Debt Service-to-Exports



Source: DSA Excel files prepared for biennial allocation proposals in 2008, 2010, 2012, 2014 and 2016; 2006 from IMF staff reports (Annex V). Baseline projection in Graph "e" of standard DSF DSA charts.

5.4 Progress on debt sustainability can also be analyzed by looking at the evolution of the proportion of countries in the different DSF risk categories. Under the hoped-for evolution, the proportion of countries in debt distress or at high risk of debt distress would decline over time, as countries migrate from high risk, to moderate risk, then to low risk and eventually graduation to borrowing solely from the non-concessional lending window. For the IDB's LICs, the proportion of countries in the different risk categories was unchanged between 2006 and 2013 (Figure 11). Then, in 2014 Honduras moved from the low risk group to the moderate risk group. In 2015, Haiti moved from the high risk of debt distress group to the moderate risk group but then returned to high risk at the end of 2016. As such, this perspective points to a slight deterioration in the trend in risk of debt distress for IDB LICs.

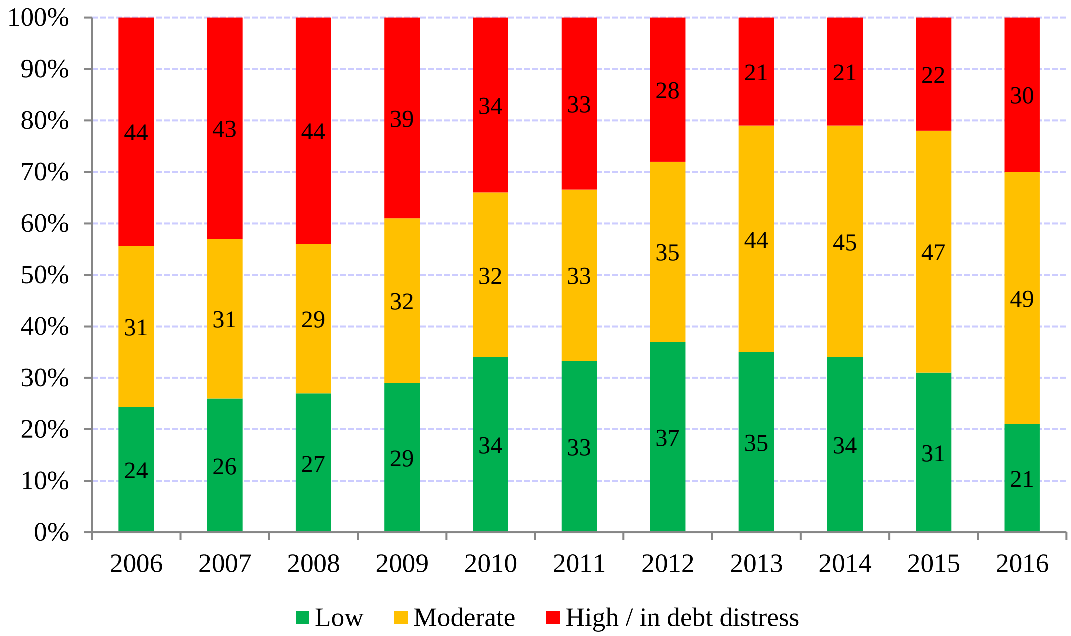
Figure 11. Evolution of Risk of Debt Distress
(In percent of number of IDB Low-Income Countries with DSAs)



Source: VPC based on IDB LIC DSAs.

5.5 At the global level, the trend in the risk of debt distress of LICs is more pronounced and clearer. There was a clear improvement in debt sustainability from 2006 until 2012-2014 (Figure 12). The proportion of countries at high risk of debt distress or in debt distress declined from 44% in 2006 to a nadir of 21% in 2013-2014. Similarly, the proportion of countries at low risk of debt distress increased from 24% in 2006 to a peak of 37% in 2012. Since 2012-2014 progress on debt sustainability has gone into reverse, with the proportion of countries at low risk declining and the proportion of countries at high risk increasing. The deterioration was particularly rapid in 2016, with the proportion of countries at low risk declining by one-third in a single year.

Figure 12. Evolution of Risk of Debt Distress
(In percent of total number of Low-Income Countries with DSAs)



Source: 2006-2015 from IMF "Macroeconomic Developments and Prospects in LIDCS: 2015", 2015; and 2016 from IMF website "List of LIC DSAs for PRGT-Eligible Countries, as of December 1, 2016".

5.6 Of further concern, the deteriorating trend is likely to continue in 2017. A number of countries already known to have moved to high risk or debt distress were still listed as "moderate" risk at the end of 2016 due to lags in the publication of DSAs. A rapid accumulation of non-concessional debt over the last decade in some countries, declines in commodity prices since 2014 and weaker global growth have contributed to the deterioration in debt sustainability.[19] The Bank will monitor whether IDB LICs start to follow the global trend over the next two years.

5.7 **Collaboration with the World Bank and the IMF**. The Bank has continued its collaboration with the WB and the IMF in the preparation of debt sustainability analyses. In April 2015, staff from the World Bank and IMF providing training in LIC Debt Sustainability Analysis to IDB country economists working on the FSO IV Countries.[20] During 2015 and 2016, the IDB continued to participate in the annual MDB/Multilateral Finance Institution (MFI) Technical Meeting on Performance-Based Allocation (PBA) Systems, as well as the annual MDB Meeting on LIC Debt Issues. As such, and in accordance with the memorandum of understanding between the regional development banks, the World Bank and IMF, the IDB and other MFIs that have harmonized around

[19] IMF "Public Debt Vulnerabilities in Low-Income Countries: The Evolving Landscape", November 2015.

[20] The DSA training workshop received a strong evaluation under KNL's methodology. The "Quality Index" (based on scores on content, instructor, and methodology) of 4.81 greatly exceeded KNL standards, while the average reported learning (2.73) also significantly exceeded the 1.5 standard learning gain for KNL (KNL Evaluation Report).

the DSF have sought to participate in an exchange of views on the 2016 review of the DSF.[21]

VI. CONCLUSIONS

6.1 Four countries (Bolivia, Guyana, Honduras and Nicaragua) [FSO-IV] were eligible for a concessional finance allocation under the EPBA/DSF for 2015 and 2016. A total of 36 operations with blended resources amounting to US$1,942 billion were approved during 2015-2016, of which US$529.2 million corresponded to FSO resources.

6.2 The Grant Leverage Mechanism, a pilot mechanism to leverage grant resources from donors that ran from September 13, 2013 to September 13, 2016, was included in this review because it was subject to the DSF. The GLM was successful in many respects. Four projects in three countries were approved using the GLM, fully utilizing the US$100 million of OC-financing approved for the GLM. The US$100 million of OC-financing "crowded in" US$67 million of grant funding and a further $25 million of non-IDB concessional financing. Nevertheless, the financing context has evolved since the time the GLM was conceived and approved. Management will prepare an analysis of the results of this pilot program before making a recommendation about continuing the program.

6.3 As foreseen in GN-2442, the lending blends for the four countries has been the principal mechanism by which the Bank has tailored the concessionality it provides to risk of debt distress indicated by the DSF. The concessionality that the IDB has provided to each country has been relatively stable over time and broadly comparable with that of other official creditors.

6.4 The CIPE structure, variables and weighting have not changed since 2012, and the IDB remains closely harmonized with other MDBs that use a performance-based allocation system. Consequently, the same CIPE variables and weights were applied for the 2012, 2014 and 2016 CIPEs. At the aggregate level, CIPE scores have maintained a broadly similar level from 2006 through 2016.

6.5 As measured by both the PPI and PMR, at the aggregate level for the FSO-IV countries portfolio performance peaked in 2011 and 2013, and then deteriorated between 2013 and 2015. Notwithstanding the recent dip, portfolio performance in the FSO-IV countries in both 2013 and 2015 was superior to the Bank average. In 2015, 83% of projects in the FSO-IV countries were classified as "satisfactory", which was 14 percentage points above the Bank average.

6.6 Since the introduction of the EPBA/DSF a decade ago, none of the FSO-IV countries has experienced debt distress. In nominal terms, sovereign-guaranteed debt owed by the FSO-IV countries to the IDB grew rapidly from 2007 to 2016. However, as a proportion

[21] Note on "Collaboration between the IMF, the World Bank and regional development banks in the preparation of debt sustainability analyses for low-income countries", December 2007. Management reported on the process to develop this MoU in "Update on implementing multilateral debt relief and concessional finance reform at the IDB", (GN-2442-14), July 2007.

of GDP, in 2016 IDB debt was less than half the level of the years preceding debt relief. Moreover, in present value terms (which incorporates the effects of concessionality), successive IDB DSAs have shown the FSO-IV average present value of public and publicly-guaranteed external debt to be anchored at around 20% of GDP.

6.7 Globally there has been a clear trend of countries moving to higher risk of debt distress classifications since 2014. This will require the Bank to monitor the situation closely.

ANNEX I

EVOLUTION OF COUNTRY INDICATORS OF THE ENHANCED PERFORMANCE-BASED ALLOCATION

	Allocation 2007-2008	Allocation 2009-2010	Allocation 2011-2012	Allocation 2013-2014	Allocation 2015-2016	Allocation 2017-2018
	Population					
Bolivia	8,986,396	9,518,000	9,862,860	10,088,108	10,671,200	10,724,705
Guyana	772,056	739,000	762,498	756,040	799,613	767,085
Honduras	7,141,464	7,091,000	7,465,998	7,754,687	8,097,688	8,075,060
Nicaragua	5,604,000	5,605,000	5,742,800	5,869,859	6,080,478	6,082,032
	GNI p/c (Atlas method)					
Bolivia	960	1,260	1,620	2,040	2,550	3,080
Guyana	990	1,300	1,450	2,900	3,750	4,090
Honduras	1,030	1,600	1,820	1,970	2,180	2,270
Nicaragua	790	980	1,000	1,170	1,780	1,940
	Portfolio performance (1-6 scale)					
Bolivia	3.27	3.97	4.51	4.63	5.22	4.04
Guyana	4.95	4.27	4.90	5.09	4.71	1.75
Honduras	4.95	5.09	4.55	5.00	3.69	6.00
Nicaragua	5.36	5.49	5.66	5.29	5.60	5.79
	CIPE (1-6 scale)					
Bolivia	3.10	3.23	3.75	3.75	3.68	3.37
Guyana	2.75	3.39	3.75	3.62	3.30	3.27
Honduras	3.85	3.95	3.72	3.58	3.38	3.43
Nicaragua	3.58	3.55	3.53	3.49	3.44	3.39

Source: GN-2442-53, GN-2442-46, GN-2442-42, GN-2442-32, GN-2442-16.

ANNEX II

2016 PORTFOLIO PERFORMANCE AND CIPE SCORES

1. Evolution of the Percentage of Undisbursed Loan Balances (ULB) represented by projects classified as “on alert” and “problem”

Country	2008	2010	2011	2013	2015
Bolivia	40.7%	29.8%	27.5%	15.6%	39.1%
Guyana	34.7%	22.0%	18.1%	25.8%	84.9%
Honduras	18.1%	28.9%	20.1%	46.3%	0.0%
Nicaragua	10.2%	6.7%	14.1%	8.0%	4.1%
Total FSO-IV	**28.9%**	**23.4%**	**21.6%**	**22.2%**	**26.4%**

Source: GN-2442-53, GN-2442-46, GN-2442-42, GN-2442-32, GN-2442-16.

2. Country Institutional and Policy Evaluation 2016

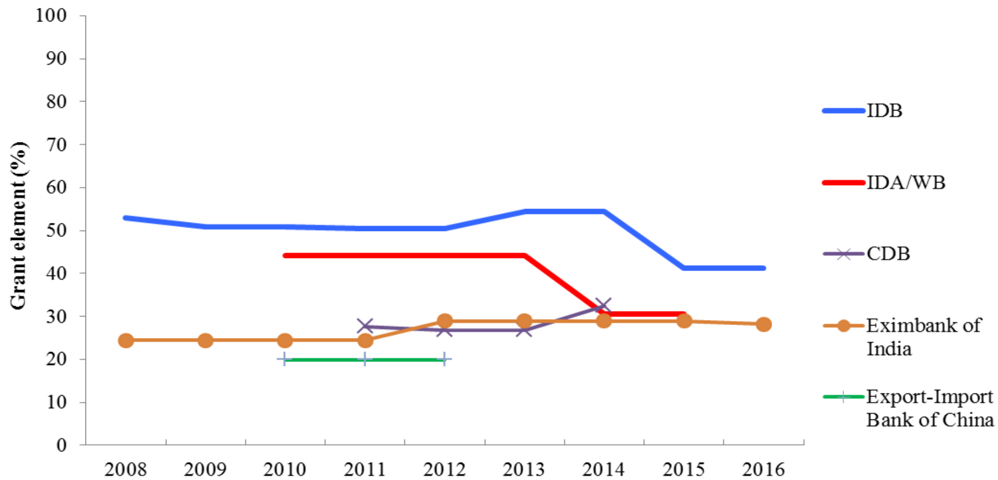
Policy Cluster and Weight	Variable	BOLIVIA Score	GUYANA Score	HONDURAS Score	NICARAGUA Score
A. Economic management (15%)	1. Monetary and exchange rate policies	3.00	4.00	3.50	4.00
	2. Fiscal policy	3.50	3.00	3.50	4.00
	3. Debt policy and management	5.00	4.00	4.00	4.00
	Policy Cluster A Score	**3.83**	**3.67**	**3.67**	**4.00**
B. Structural policies (20%)	4. Trade	3.45	3.02	3.71	3.73
	5. Financial sector	3.50	3.35	3.79	3.54
	6. Business regulatory environment	2.60	3.31	3.26	3.10
	7. Policies and institutions for environmental sustainability	3.24	3.19	3.38	3.33
	Policy Cluster B Score	**3.20**	**3.22**	**3.53**	**3.43**
C. Social inclusion/equity policies (35%)	8. Gender equality, indigenous peoples and people of African descent	3.76	3.36	3.44	3.59
	9. Equity of public resource use	3.67	3.33	4.00	3.33
	10. Building human resources	3.45	3.52	3.78	3.65
	11. Social protection and labor	3.50	3.20	3.50	3.00
	Policy Cluster C Score	**3.59**	**3.35**	**3.68**	**3.39**
D. Public sector management and institutions (30%)	12. Property rights and rule-based governance	2.74	3.12	2.64	3.10
	13. Quality of budgetary, procurement and financial management	3.13	3.13	3.38	3.63
	14. Efficiency of revenue mobilization	3.50	3.25	3.50	3.50
	15. Quality of public administration	2.51	2.85	2.45	2.69
	16. Transparency, accountability and corruption in the public sector	3.15	2.65	2.73	2.32
	Policy Cluster D Score	**3.00**	**3.00**	**2.94**	**3.05**
	Total Score	**3.37**	**3.27**	**3.43**	**3.39**

Source: GN-2442-53.

ANNEX III

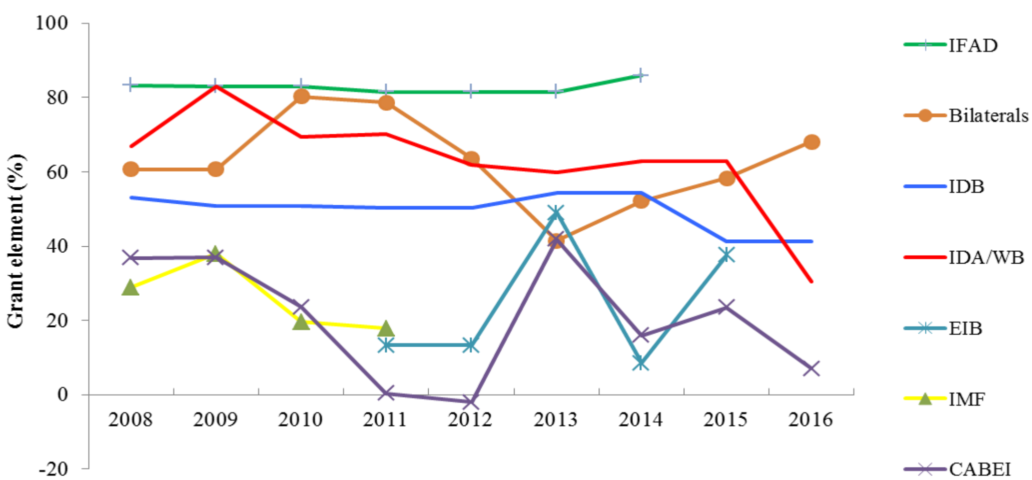
ESTIMATED CONCESSIONALITY OF NEW EXTERNAL LOANS CONTRACTED BY CREDITOR (GUYANA AND NICARAGUA)

Guyana



Sources: IDB concessionality from biennial FSO allocation proposals; data on lending terms and loan amounts from non-IDB creditors provided by Guyana Ministry of Finance, with concessionality for all years calculated with the IMF Concessionality Calculator and the unified discount rate of 5%.
Note: Refers to the concessionality of new loans contracted during the reporting year. Average concessionality for each creditor is weighted by size of loans contracted in that year. For presentational purposes, if no loans were contracted from a creditor for an intermediate year, the concessionality from the previous year was carried over.

Nicaragua



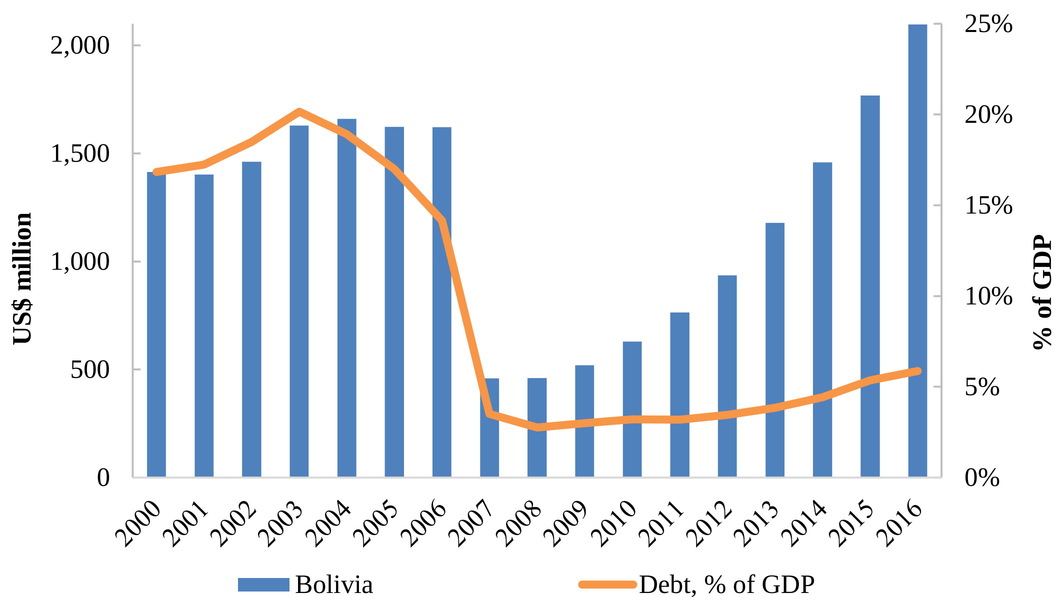
Sources: IDB concessionality from biennial FSO allocation proposals; data on concessionality and loan amounts from non-IDB creditors from Central Bank of Nicaragua: table on external loans contracted during the year, annual “Report on Public Debt”, 2008 2016.
Note: Refers to the concessionality of new loans contracted during the reporting year. Average concessionality for each creditor is weighted by size of loans contracted in that year. For presentational purposes, if no loans were contracted from a creditor for a year, the concessionality from the previous year was carried over.

ANNEX IV

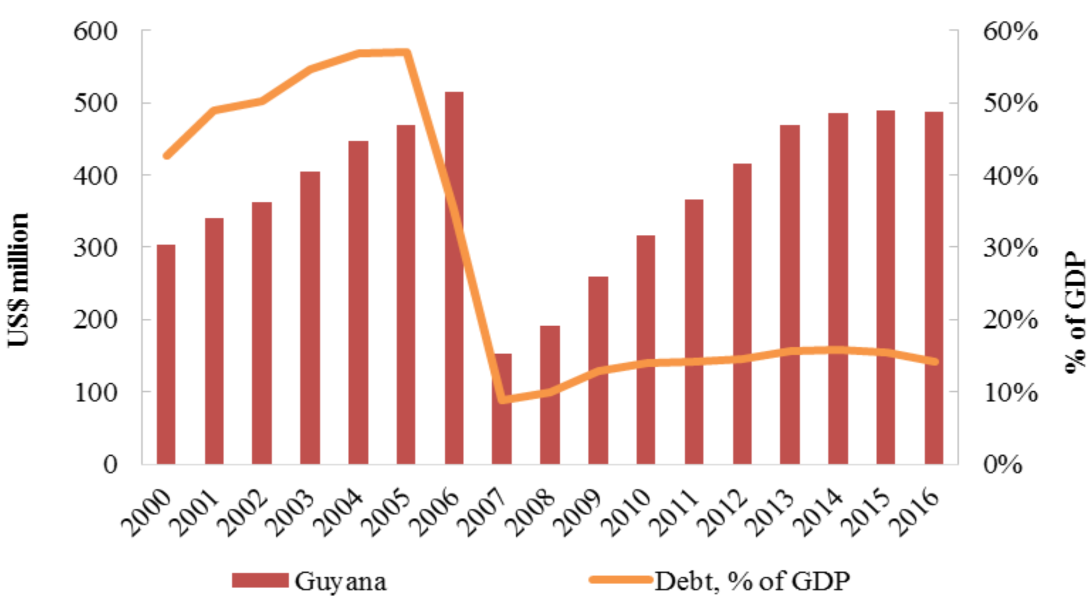
OUTSTANDING SOVEREIGN GUARANTEED DEBT TO THE IDB BY COUNTRY

Sources: Debt data, FIN; 2000-2015 GDP, World Bank, World Development Indicators; projected 2016 GDP, IMF October 2016 World Economic Outlook database.

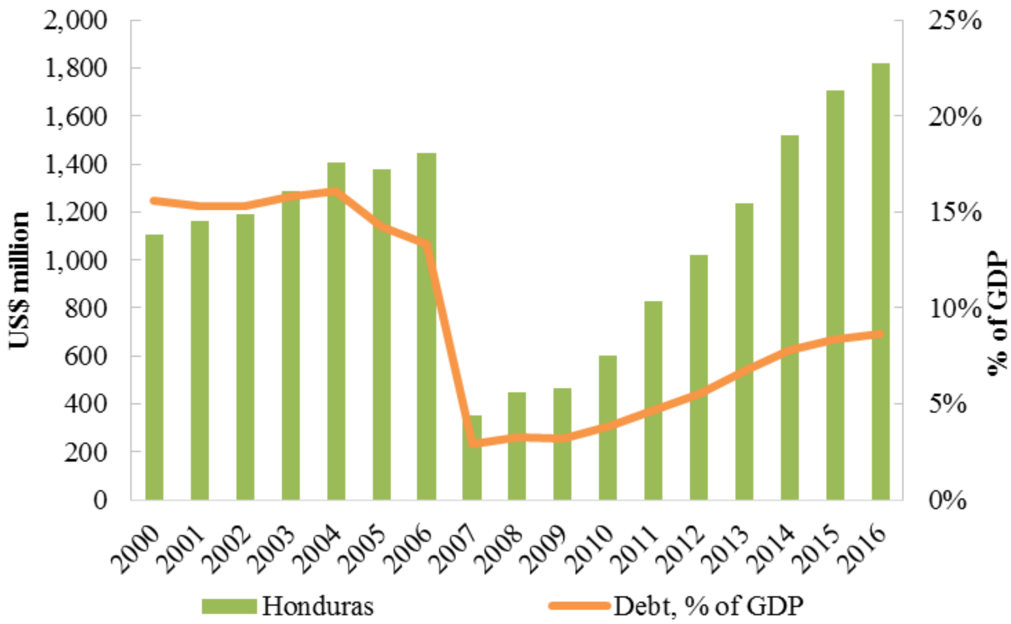
Bolivia



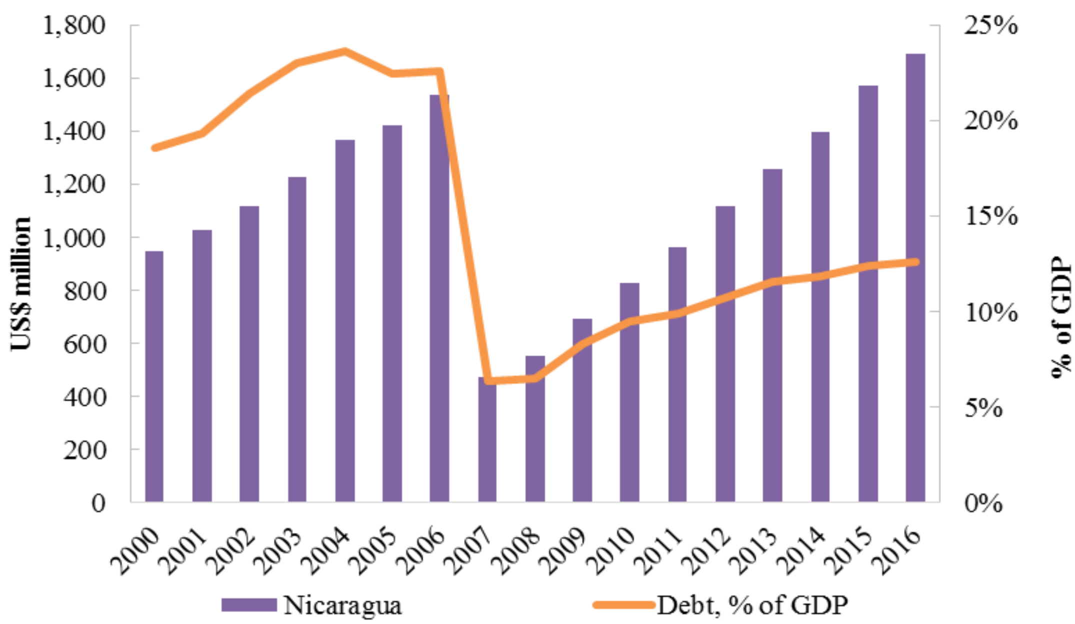
Guyana



Honduras



Nicaragua

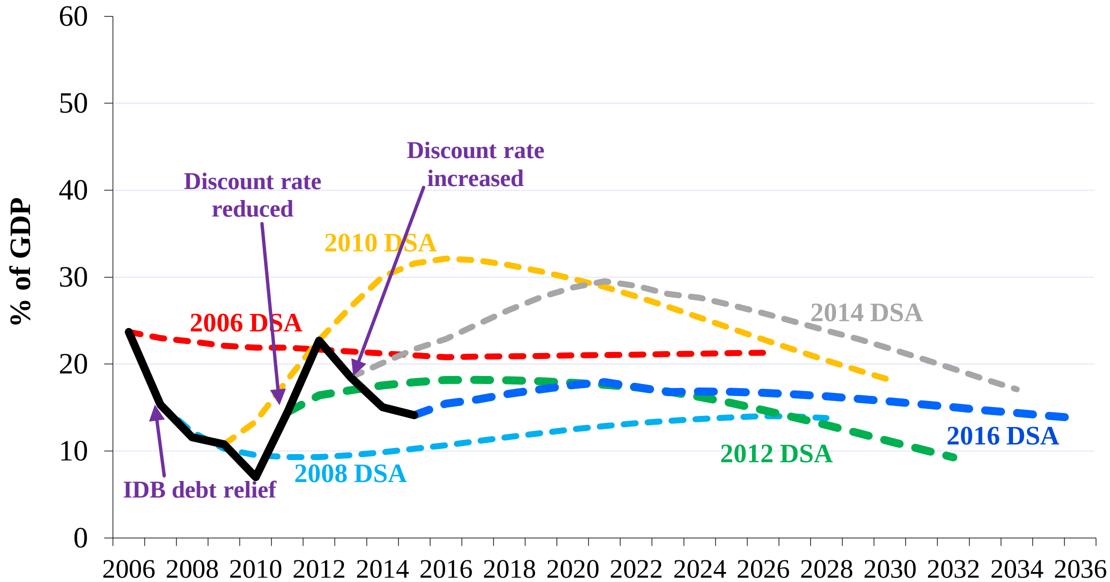


ANNEX V

EVOLUTION OF DSA PROJECTIONS BY COUNTRY

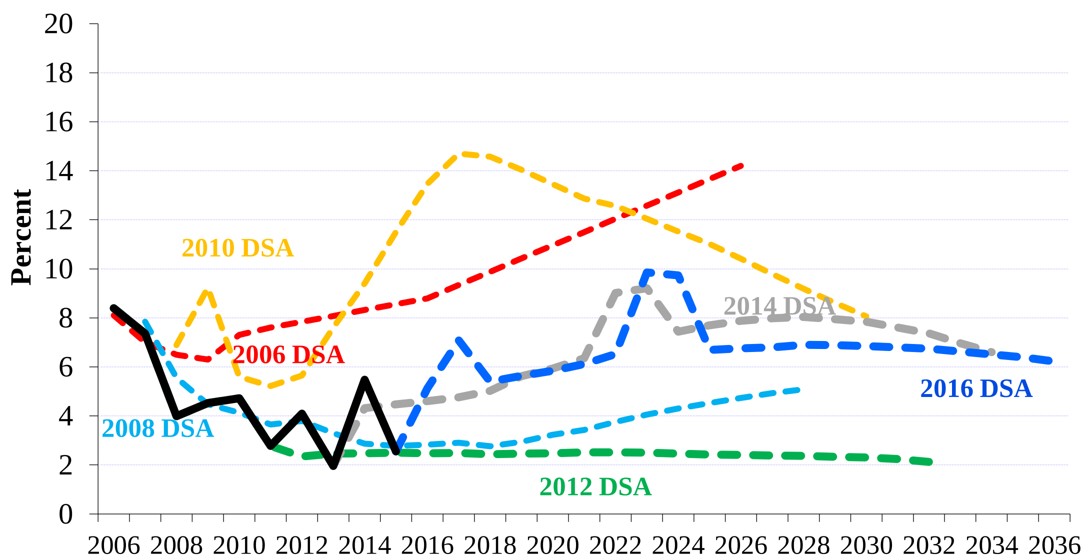
Bolivia

The Evolution of Baseline Projections of Present Value of Public and Publicly-Guaranteed External Debt-to-GDP Ratio



Source: DSA Excel files prepared for biennial allocation proposals in 2008, 2010, 2012, 2014 and 2016; 2006 from IMF 2006 Article IV Consultation (Country Report 06/270) [July 2006].

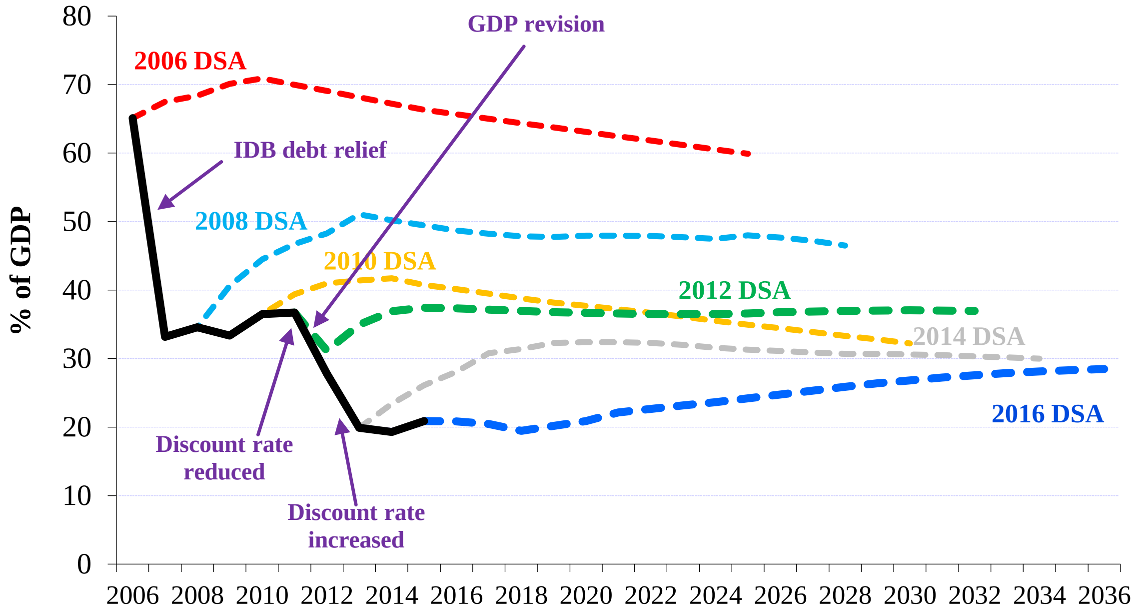
The Evolution of Baseline Projections of Debt Service-to-Exports



Source: DSA Excel files prepared for biennial allocation proposals in 2008, 2010, 2012, 2014 and 2016; 2006 from IMF 2006 Article IV Consultation (Country Report 06/270) [July 2006].

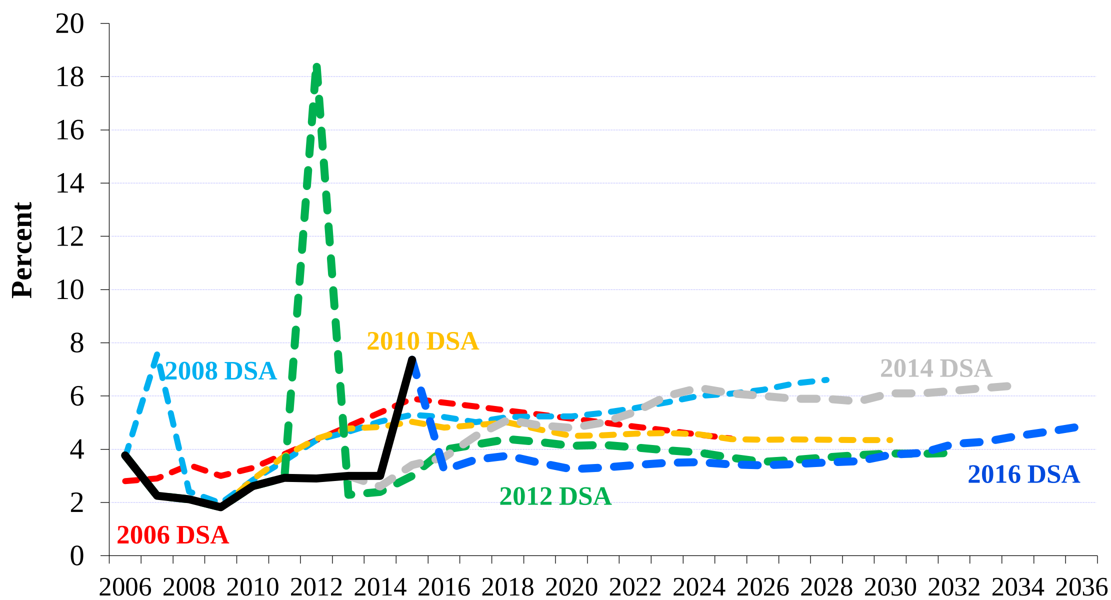
Guyana

The Evolution of Baseline Projections of Present Value of Public and Publicly-Guaranteed External Debt-to-GDP Ratio



Source: DSA Excel files prepared for biennial allocation proposals in 2008, 2010, 2012, 2014 and 2016; 2006 from Guyana Joint World Bank/IMF DSA 2005 (IMF EBS/06/11) [January 2006].

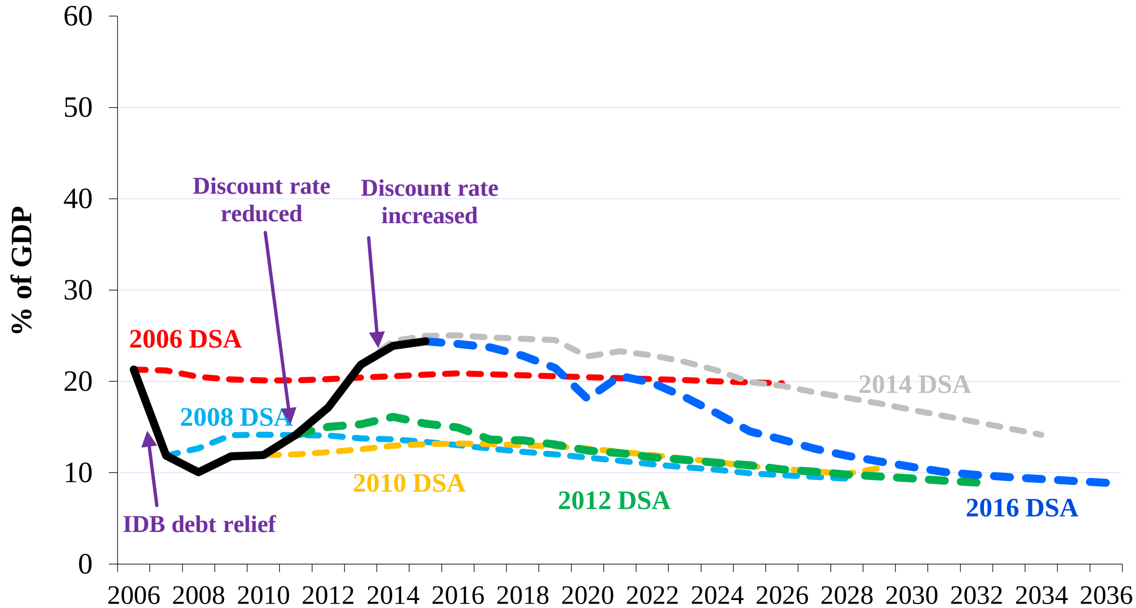
The Evolution of Baseline Projections of Debt Service-to-Exports



Source: DSA Excel files prepared for biennial allocation proposals in 2008, 2010, 2012, 2014 and 2016; 2006 from Guyana Joint World Bank/IMF DSA 2005 (IMF EBS/06/11) [January 2006].

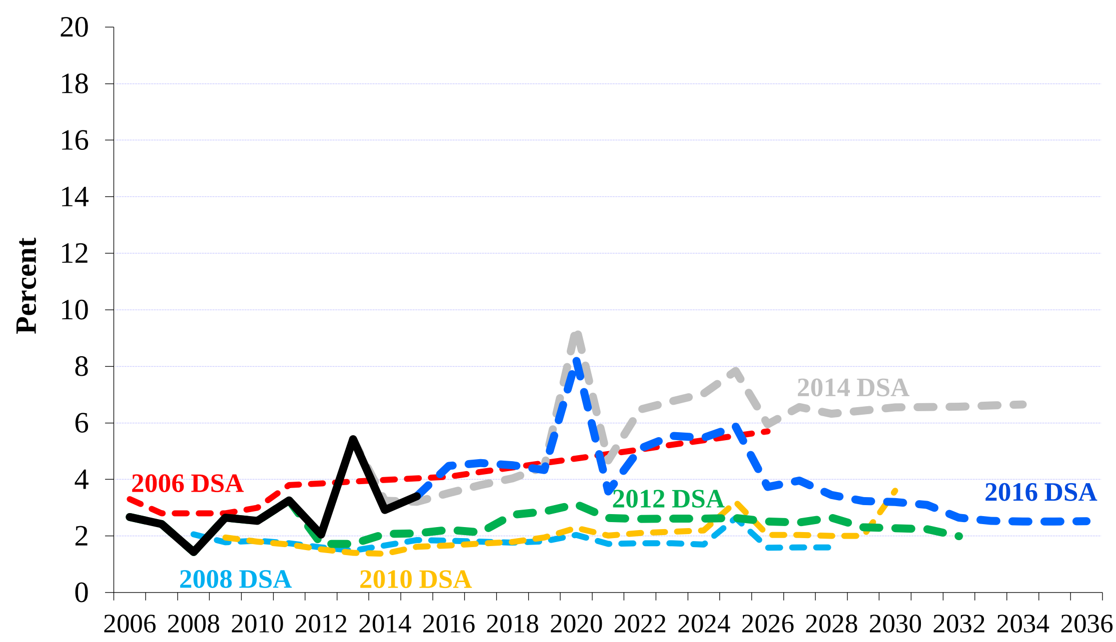
Honduras

The Evolution of Baseline Projections of Present Value of Public and Publicly-Guaranteed External Debt-to-GDP Ratio



Source: DSA Excel files prepared for biennial allocation proposals in 2008, 2010, 2012, 2014 and 2016; 2006 from IMF 2006 DSA (Country Report 06/442) [October 2006].

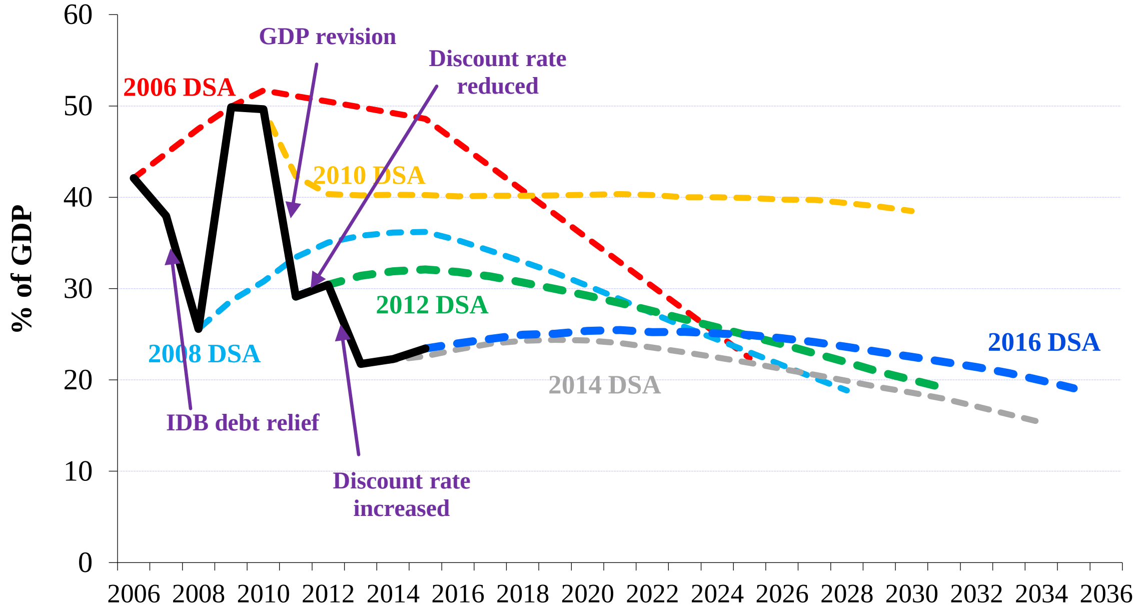
The Evolution of Baseline Projections of Debt Service-to-Exports



Source: DSA Excel files prepared for biennial allocation proposals in 2008, 2010, 2012, 2014 and 2016; 2006 from IMF 2006 DSA (Country Report 06/442) [October 2006].

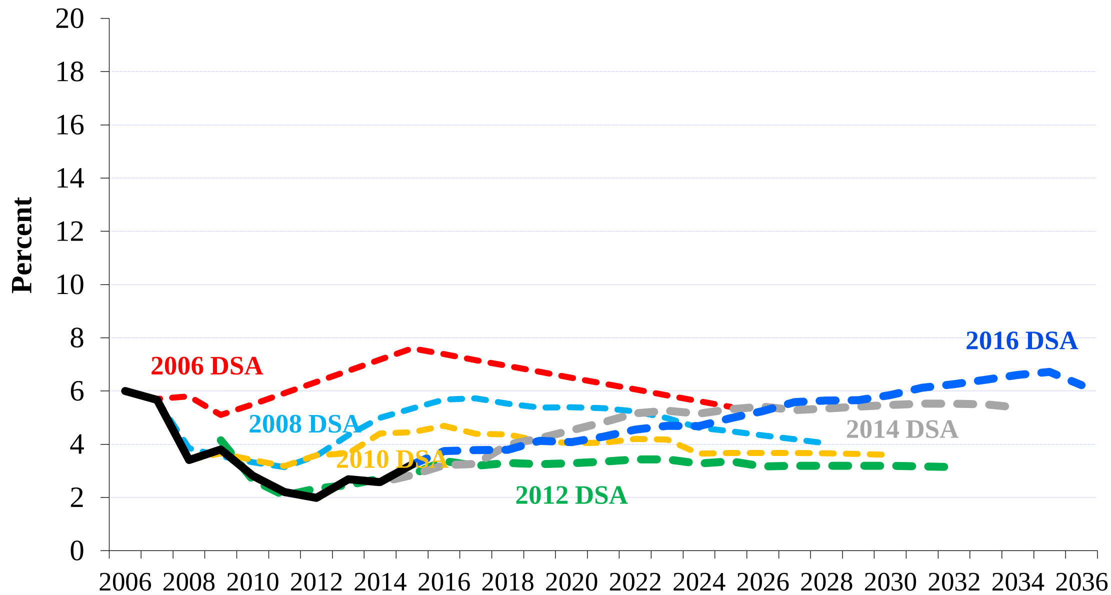
Nicaragua

The Evolution of Baseline Projections of Present Value of Public and Publicly-Guaranteed External Debt-to-GDP Ratio



Source: DSA Excel files prepared for biennial allocation proposals in 2008, 2010, 2012, 2014 and 2016; 2006 from IMF 2005 Article IV Consultation (Country Report 06/174) [May 2006].

The Evolution of Baseline Projections of Debt Service-to-Exports



Source: DSA Excel files prepared for biennial allocation proposals in 2008, 2010, 2012, 2014 and 2016; 2006 from IMF 2005 Article IV Consultation (Country Report 06/174) [May 2006].