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PROPOSAL FOR ADJUSTMENTS TO THE ENHANCED PERFORMANCE-
BASED ALLOCATION/DEBT SUSTAINABILITY FRAMEWORK

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ABBREVIATIONS

AsDB	Asian Development Bank
AfDB	African Development Bank
CDB	Caribbean Development Bank
CIPE	Country Institutional and Policy Evaluation
COC	Concessional Ordinary Capital
CPIA	Country Policy and Institutions Assessment
DSEP	Debt Sustainability Enhancement Program
DSF	Debt Sustainability Framework
EPBA	Enhanced Performance-Based Allocation
FSO	Fund for Special Operations
GAF	Grant Allocation Framework
GEF	Global Environment Facility
GDP	Gross Domestic Product
GNI	Gross National Income
GRF	IDB Grant Facility
HIPC	Heavily Indebted Poor Countries
IDA	International Development Association
IDS	International Debt Statistics
IFAD	International Fund for Agricultural Development
IFF	Intermediate Financing Facility
IFI	international financial institution
IMF	International Monetary Fund
LIC	low-income country
MDB	multilateral development bank
MDRI	Multilateral Debt Relief Initiative
OC	Ordinary Capital
PBA	Performance-Based Allocation
PCO	Program of Creditor Outreach
PPA	Performance and Policy Action
PPI	Portfolio Performance Indicator
SDFP	Sustainable Development Finance Policy
VPC	Vice Presidency of Countries

EXECUTIVE SUMMARY

The purpose of this document is to submit for the consideration of the Board of Executive Directors a proposal for adjustments to the Enhanced Performance-Based Allocation and Debt Sustainability Framework (EPBA/DSF). The proposal will update the framework by taking into account: (i) the experience and lessons learned with the EPBA/DSF over the last 14 years; (ii) changes in the international context and methodologies with which the Bank is harmonized; and (iii) an extensive process of dialogue with the Board during 2020.

The proposal seeks to preserve those aspects of the EPBA/DSF that have worked well from 2007-2020 (for example, smooth concessionality transitions and “clean” performance-based country allocations) while addressing those aspects that need to be updated.

The document proposes three adjustments to the EPBA/DSF. The first two adjustments affect the EPBA side of the framework and constitute greater harmonization with other MDBs that use a performance-based allocation (PBA) system for the allocation of concessional resources. The third adjustment affects the DSF/concessionality side.

The first adjustment proposed is to reduce the exponent on Gross National Income per capita in the PBA formula from -1 to -0.125. This exponent would thus become harmonized with that of the World Bank/International Development Association and of the African Development Bank. No other element of the PBA formula will be changed. This change will allow the Bank to implement the reincorporation of Haiti into the PBA system in a smooth manner and allow the IDB PBA to continue to work without allocation floors, ceilings, or other interventions.

The second proposed adjustment is to expand the definition of the PBA envelope from just the concessional resource part of the allocation to the entire allocation of resources in a biennial resource allocation to countries eligible for concessional resources. This adjustment would provide a clear separation between the role of the PBA, on the one hand, to determine the allocation and volume of resources, and the role of the DSF, on the other hand, to affect the concessionality of such allocation. This adjustment would harmonize the IDB with the practices of the other four IFIs using a PBA and the DSF.

The third proposed adjustment is to complement the DSF with three additional variables to determine the financing blend and concessionality of biennial EPBA allocations. The addition of these three variables will add stability to the framework and help to ensure smoother concessionality trajectories in the future (in particular, protecting Haiti from an unduly abrupt reduction in concessionality), as well as to fully harmonize the Bank’s internal regulations regarding countries classified at high risk of debt distress. Broadening the framework for determining concessionality would allow the IDB to remain harmonized with DSF in a more sustainable way.

I. INTRODUCTION

- 1.1 **The purpose of this document is to submit for the consideration of the Board of Executive Directors a proposal for adjustments to the Enhanced Performance-Based Allocation and Debt Sustainability Framework (EPBA/DSF),** which was approved by the Board of Executive Directors in February 2007.¹ These adjustments do not change the purpose and core principles of the Bank’s concessional resources framework (EPBA/DSF)², including the use of a performance-based allocation system for concessional resources and the link between the risk of debt distress (under the DSF) and the concessionality of allocations as set forth in document GN-2442. The proposal will update the framework by taking into account: (i) the experience and lessons learned with the EPBA/DSF over the last 14 years; (ii) changes in the international context and methodologies with which the Bank is harmonized; and (iii) an extensive process of dialogue with the Board during 2020.³ During this dialogue process the Board has communicated its overall satisfaction with the EPBA/DSF and successes, such as the gradual concessionality transition for eligible countries, while expressing interest in: updating the framework to ensure continue relevance and consistency with best practice, incorporation of country vulnerability considerations, and lessening concessional resource allocation volatility, particularly with regard to sharp downward adjustments in allocation volumes related to the DSF.

II. THE INTERNATIONAL PERFORMANCE-BASED ALLOCATION (PBA)/DEBT SUSTAINABILITY FRAMEWORK (DSF) FRAMEWORK

- 2.1 **Since the early 2000s, multilateral development banks and other international financial agencies have made increased efforts to harmonize their systems for the allocation of concessional assistance and harmonize the terms on which assistance is provided.** The general approach followed by MDBs has been to use a performance-based allocation (PBA) system to allocate the volume of concessional resources and a debt sustainability analysis to determine the financial terms or degree of concessionality on which concessional resources are provided.
- 2.2 **The rationale for PBA systems is to maximize the development effectiveness of scarce concessional resources.** PBA systems steer, on the margin, relatively more resources to countries with higher needs (lower income and larger population sizes) and the best ability

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](#)), February 2007.

² The EPBA/DSF framework used for the allocation of concessional resources is composed of two parts: (i) the EPBA, which determines the allocation and volume of concessional resources; and (ii) the DSF, which determines the blending of OC resources and the level of concessionality. Both parts of the framework have their own variables. The EPBA’s variables are: (i) population size; (ii) Gross National Income (GNI) per capita; and (iii) performance. The DSF part’s only variable is the risk of debt distress.

³ (i) Overview of IDB Concessional Resource Framework ([PP-1027](#)); (ii) Rules for Country Eligibility to Concessional Resources ([PP-1036](#)); (iii) The Enhanced Performance Based Allocation (EPBA) ([PP-1075](#)); and (iv) Concessionality/Debt Sustainability Framework (DSF) ([PP-1094](#)).

to use the resources productively, where the latter is understood as countries with the highest quality public policies and strongest portfolio implementation capacity.

- 2.3 **The International Development Association (IDA) was the first MDB to introduce a PBA system to allocate concessional resources.** The regional MDBs adopted PBAs in the 1999-2002 period (Table 1). Two additional international financial institutions – the International Fund for Agricultural Development (IFAD) and the Global Environment Facility (GEF) – adopted PBAs in 2003 and 2006 respectively.⁴ The PBA allocation formulas for concessional resources in the MDBs and IFIs differ in the weight attached to each variable but nearly all comprise a “needs” variable, which takes into account population size and per capita Gross National Income (GNI), and a “performance” variable (Annex I). In turn, the performance variable has comprised an assessment of policies and institutions at the country level and an evaluation of portfolio performance. The assessment of policies and institutions has generally been harmonized with the World Bank’s Country Policy and Institutions Assessment (CPIA), while the evaluation of portfolio performance has been more specific to each institution.

Table 1. Year of Adoption of PBAs by IFIs/MDBs

Year	International Organization
1977	International Development Association
1999	African Development Bank
2000	Caribbean Development Bank
2001	Asian Development Bank
2002	Inter-American Development Bank
2003	International Fund for Agricultural Development
2006	Global Environment Facility

Source: Adapted from IFAD “Corporate-level evaluation of IFAD’s performance-based allocation system: Approach Paper”, EC 2015/87/W.P.4/Rev.1, April 2015.

- 2.4 **While a PBA system has been used to determine the volume of concessional resources allocated to countries, a second set of frameworks and policies has been used to determine the financial terms or degree of concessionality on which concessional resources are provided:** (i) a Debt Sustainability Framework for low-income countries (DSF); (ii) a Grant Allocation Framework (GAF); and (iii) a Non-Concessional Borrowing Policy (NCBP).⁵

⁴ These seven institutions maintained the use of a PBA from 2006 to date.

⁵ For the purposes of precision, this document distinguishes between the DSF and the GAF. In the early post-MDRI years, the GAF was treated as an adjunct of the DSF (including in GN-2442). However, the DSF and GAF are separate, albeit closely connected frameworks. The DSF is a joint WB-IMF framework, whereas the GAF is an IDA framework.

- 2.5 **In the context of the Heavily Indebted Poor Countries ([HIPC](#)) and Multilateral Debt Relief Initiative ([MDRI](#)) debt relief initiatives, the joint World Bank-IMF Debt Sustainability Framework for Low Income Countries (LIC DSF) was launched in April 2005, with the goal of ensuring that external financing to low-income countries would not lead to unsustainable debt burdens.⁶ The main objectives of the DSF were to:⁷**
- Guide the borrowing decisions of LICs in a way that matches their financing needs with their current and prospective repayment ability;
 - Provide guidance for creditors’ lending and grant allocation decisions to ensure that resources are provided to LICs on terms that are consistent with both progress towards their development goals and long-term debt sustainability; and
 - Help detect potential crisis early so that preventive action can be taken.
- 2.6 **Under the DSF, a debt sustainability analysis (DSA) is used to classify countries according to their risk of debt distress. There are four categories of risk of debt distress: low risk, moderate risk, high risk and “in debt distress”.⁸**
- 2.7 **The IDA Grant Allocation Framework (GAF) then translates DSF debt distress risk ratings into "traffic lights", which then determine the share of IDA grants and highly concessional IDA credits for each country. Countries at high risk or in debt distress (red light) can receive their PBA allocation 100% in the form of grants, medium-risk countries (yellow light) receive their allocation as 50% grants and 50% concessional loans, while low-risk countries (green light) receive their allocation solely as a concessional loan. By boosting the share of grants for countries at risk of debt distress, the DSF/GAF frameworks are intended to help restore or maintain external debt sustainability.**
- 2.8 **IDA began to apply the GAF in its fourteenth replenishment cycle, which covered the period from July 1, 2005 to June 30, 2008.⁹ Four of the other six institutions using a PBA soon harmonized with IDA’s use of the DSF-GAF too.¹⁰ The DSF-GAF framework remains in effect to date.**

⁶ IMF and IDA (2004) “Debt Sustainability in Low-Income Countries -- Proposal for an Operational Framework and Policy Implications”, Washington, D.C.

⁷ IMF and World Bank (January 2012), “Revisiting the Debt Sustainability Framework for Low-Income Countries”, Washington, D.C.

⁸ Since 2017, the moderate risk of debt distress has been disaggregated into three sub-categories: moderate risk with “substantial space to absorb shocks”, “some space”, and “limited space”. “Space” refers to how far the country’s debt burden indicators are from crossing the debt thresholds in the baseline scenario. Such breaches would trigger the “high” risk of debt distress rating [IMF (2017) “Review of the Debt Sustainability Framework for Low Income Countries: Proposed Reforms”].

⁹ IDA (2004a) “Debt Sustainability and Financing Terms in IDA14”; IDA (2004b) “Debt Sustainability and Financing Terms in IDA14: Further Considerations on Issues and Options and IDA (2005) “Summary of IDA 14 Policies for Operational Staff”, Washington, D.C.

¹⁰ The four were: the [African Development Bank](#) (2005); the [Asian Development Bank](#) (2007); the IDB (2007); and [IFAD](#) (2007). For the remaining two institutions: the GEF provides its assistance entirely in the form of grants and the Caribbean Development Bank uses a country group system (largely based on per capita income) to determine its financing terms.

- 2.9 **The third pillar of the frameworks and policies on the debt sustainability/concessional side was a non-concessional borrowing policy (NCBP).** IDA’s Executive Directors approved IDA’s [NCBP](#) in July 2006, and between July 2006 to June 2020 the NCBP applied to countries eligible for IDA grants and to IDA-only recipients of assistance under the Multilateral Debt Relief Initiative (MDRI). The NCBP was a two-pronged policy involving creditor outreach as well as measures aimed at borrowers to reduce the risk of overborrowing. Through creditor outreach the NCBP aimed to encourage other creditors to incorporate debt sustainability considerations and the information provided by the Debt Sustainability Framework (DSF) into their lending decisions. The second prong, aimed at borrowers, included capacity building efforts to help countries manage their debt and a renewed emphasis on improved adherence to reporting requirements. The second prong also involved IDA responses for cases in which the NCBP is breached, such as reductions in allocation volumes, or adjustment of IDA lending terms.
- 2.10 **A key building block of the NCBP was the establishment of debt limits and a minimum grant element of new borrowing for countries subject to the policy.** The NCBP was not a blanket restriction on non-concessional borrowing and it included a differentiated methodology for setting debt limits based on a country's macroeconomic and public financial management capacity and debt vulnerability.

III. HOW THE IDB HARMONIZED WITH THE PERFORMANCE-BASED ALLOCATION-DEBT SUSTAINABILITY FRAMEWORKS

- 3.1 **The IDB was one of four IFIs to harmonize with the PBA-DSF/GAF/NCBP frameworks.** The IDB harmonized closely -- and increasingly closely over time -- with the PBAs used by other MDBs. It harmonized with the DSF/GAF/NCBP side conceptually, but with important differences operationally. While such operational differences did not generate problems during the first decade of operation, by the time of the “*Review of the Implementation of the EPBA/DSF 2017-2018*” (GN-2442-68) signs were emerging that these differences need to be addressed [see section IV. B. below].

A. The Performance-Based Allocation (PBA) System

- 3.2 **The IDB harmonized closely with the PBAs used by other MDBs and the degree of harmonization has increased over time.** The IDB adopted a performance-based allocation system for concessional resources in 2002. On June 19, 2002 the Board of Executive Directors approved document GN-1856-31 “Proposal for a Performance Based Allocation of FSO Resources”.¹¹ The document defined an allocation methodology based on population, Gross National Product per capita, a Country Institutional and Policy Evaluation (CIPE), and portfolio performance. Shortly afterwards, the Board of Executive Directors approved a similar methodology for the Bank’s other arm of concessional resources – the Intermediate Financing Facility (IFF).¹²

¹¹ Strategic Planning and Budget Department (June 2002) “Proposal for a performance-based allocation of FSO resources. New revised version.” (GN-1856-31).

¹² Strategic Planning and Budget Department (July 2002) “Proposal for a performance-based allocation of IFF resources for the period 2002-2003.” (FN-263-24). The IFF methodology included population, GDP per capita, the CIPE, portfolio performance, and the ratio of debt service to official creditors to exports of goods and service. As of

- 3.3 **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 (EPBA) framework”.** GN-2442 significantly reformed the PBA, introducing an exponential formula, similar to the one used by IDA and other multilateral organizations. The EPBA formula for concessional resources has three major elements: (i) population size; (ii) Gross National Income (GNI) per capita; and (iii) performance. Performance is estimated as the weighted average of the quality of the institutional and policy framework (70%), as measured by the aforementioned CIPE, and portfolio performance (30%).¹³
- 3.4 **Several features of the IDB’s EPBA formula relative to those of other MDBs are noteworthy (Annex I).** The IDB -- like IDA -- has retained a simple, uncomplicated formula whose results are relatively easy to understand and transparent. The exponent of the performance variable gives a premium to improvements in performance but appears well balanced. The exponent of 2 is the modal choice and median of IFIs using PBAs (Annex I).¹⁴ The weighting of the policy and institutional performance relative to portfolio performance allows sufficient incentive for improvements in portfolio performance while retaining policy and institutional performance as the principal element of performance. The exponent on the population variable is smaller than that of IDA and the African Development Bank, but similar to that of the Asian Development Bank and IFAD. The IDB’s exponent on the GNI per capita variable is an outlier – it is eight times that of IDA and the AfDB, and four times that of the AsDB and IFAD.
- 3.5 **The principal component of the performance variable – the CIPE – has also become more harmonized with the World Bank’s CPIA over time.**¹⁵ The first CIPE, introduced in 2002, was only loosely based on the CPIA at the time. The 2007 reform of the PBA did not alter the CIPE, but the CIPE’s content was substantially harmonized with the CPIA in 2010. Additional content harmonization occurred in 2012 and since then the CIPE has been updated to mirror changes in the CPIA. The cluster weights of the CIPE, which give disproportionate weight to the four social variables, were introduced in 2002 with Board approval and have not changed over time.

B. The Debt Sustainability Framework (DSF)

- 3.6 **The IDB harmonized with the joint WB-IMF LIC DSF in February 2007, when the Board of Executive Directors 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 (EPBA) framework”.** The harmonization is absolute and the IDB follows any

2002, five countries were eligible for FSO resources (Bolivia, Guyana, Haiti, Honduras and Nicaragua) and seven countries were eligible for IFF resources (the Dominican Republic, Ecuador, El Salvador, Guatemala, Jamaica, Paraguay and Suriname).

¹³ $(POP^{0.5} \times GNIpc^{-1} \times [0.7*CIPE + 0.3*PPI]^2)$.

¹⁴ IDA had an exponent of 2 on the performance variable from 2002-2008, which was raised to 5 in 2008. The performance exponent was reduced from 5 to 4 in 2014 ([IDA17](#)) and then to 3 in 2017 ([IDA18](#) and [IDA19](#)).

¹⁵ See [A Brief History of the CIPE at the IDB](#).

changes in the methodology due to revisions in the DSF. The IDB also uses the IMF's [Concessional Calculator](#) and methodology for the purposes of calculating concessionality and uses the DSF [discount rate](#) for debt sustainability analyses and concessionality calculations. The IDB used IMF DSAs for the initial allocation of concessional resources in 2007-2008 but has subsequently prepared independent DSAs for concessional allocation proposals.¹⁶

C. The Grant Allocation Framework (GAF)

- 3.7 **The IDB also harmonized with the GAF in 2007, but with three important deviations.** Per GN-2442, in 2007 the IDB adopted the central GAF principle of adjusting its financing composition and concessionality in accordance with the DSF risk of debt distress (“traffic light system”). The risk of debt distress became the sole criterion for determining financing composition and concessionality.¹⁷ It replaced a country group system -- primarily based on income per capita and country size -- that had determined concessionality for the period from 1972-2006. In addition, the IDB established the IDB Grant Facility as part of the multilateral debt relief and concessional finance reform, in order to provide grant financing to low-income countries rated at “high risk of debt distress”.¹⁸
- 3.8 **The first major departure from the GAF regarded the composition of financing.** The IDB faced an operational challenge in replicating the GAF model exactly. Following MDRI, the FSO was severely depleted and its ability to provide a sufficient volume of concessional loans for countries at low and moderate risk of debt distress was constrained.¹⁹ The IDB addressed this challenge by adopting a parallel loan structure that blended a sub-loan from the Ordinary Capital on regular terms with a sub-loan from the Fund for Special Operations on highly concessional terms. The relative proportion of OC and FSO loans could be altered to adjust the resulting average concessionality of the parallel loan.²⁰ In this way, the IDB was able to mimic the GAF’s structure of a single concessional loan for low-income countries with low risk of debt distress and allocations

¹⁶ World Bank and IMF staff have provided periodic training courses to IDB Country Economists on producing DSAs under the WB/IMF LIC DSF. IDB Country Economists use the WB/IMF DSA Excel templates as the base for their DSAs and follow LIC DSF guidelines.

¹⁷ The practice of the risk of debt distress being the sole determinant of the level of concessionality started in 2007. From 1959-1972, IDB concessional resources (FSO) were directed on a sectoral basis (broadly, towards the social sectors). From 1972-2006, concessional resources were allocated on a country basis and the principal determinants of the level of concessionality were per capita income and vulnerability (small economic size). The risk of debt distress came to be the sole determinant of the level of concessionality in 2007, following multilateral debt relief and with debt sustainability concerns paramount.

¹⁸ “Multilateral debt relief and concessional finance reform at the Inter-American Development Bank. IDB Grant Facility. New revised version (GN-2442-11). Haiti was the only low-income IDB member country to be rated at high risk of debt distress from 2007-2020.

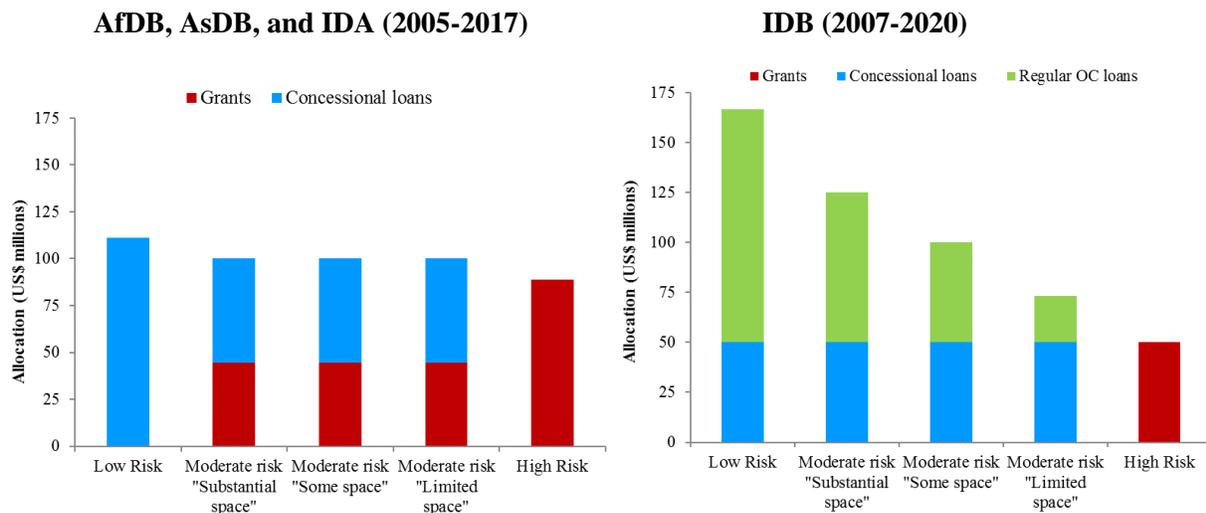
¹⁹ The fund balance of the FSO declined from US\$9 billion on December 31, 2005 to US\$5.8 billion on December 31, 2006 (IDB Annual Financial Statements).

²⁰ “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), February 2007.

of 50% concessional loan and 50% grants for low-income countries with a moderate risk of debt distress.

- 3.9 **The second major departure from the GAF regarded the treatment of allocation volumes.** At IDA, the AfDB, the AsDB, and IFAD, the GAF has been and is used to determine the concessionality of low-income countries' PBA's allocation but has not been used to determine the volume of concessional allocations.²¹ In contrast, at the IDB the GAF has not only determined concessionality but also has had a major impact on the volume of allocations. Since 2007 the PBA has applied only to FSO/COC resources, and the aforementioned blending of OC resources has occurred outside of the PBA. Consequently, the GAF has acted with a multiplier effect, sharply expanding the volume of allocations as countries move to lower levels of debt distress risk and sharply contracting the volume of allocations as countries move to higher levels of debt distress risk (Figure 1).

Figure 1. Illustrative comparison of allocation volumes by DSF risk of debt distress relative to a benchmark allocation of US\$100 million



Source: VPC based on [AfDB debt sustainability and grant eligibility](#), [AsDB allocation ADF resources](#), [IDA financing](#), and IDB biennial concessional allocation proposals.

- 3.10 **The third major departure from the GAF regarded the income ceiling to which it would apply.** At IDA, the DSF is applied to all IDA-only countries and a risk of debt distress is determined. However, the GAF is applied only to IDA countries with incomes below the IDA operational income cut-off.²² IDA countries above the income cut-off – called “blend countries” -- receive their PBA allocations in the form of a single, concessional loan that is less concessional than the concessional loan to “low-risk” low-

²¹ AfDB and AsDB apply a 20% volume discount to allocations of grants, which causes a 10% reduction in overall allocation volumes when moving from low risk to moderate risk or from moderate risk to high risk. IDA applied this discount from 2005-2017 but eliminated the grant discount in mid-2017. Consequently, since mid-2017, the GAF has had zero impact on concessional allocation volumes at IDA.

²² For the period July 2020-June 2021, the IDA operational income cut-off is [US\\$1.185](#).

income countries. The traffic light system is not applied to blend countries, and financing terms/concessionality are invariable to the risk of debt distress rating. Since IDA stopped applying the GAF to Nicaragua in July 2015, the IDB has been the only creditor applying the GAF to Guyana, Honduras, and Nicaragua.²³ IDA and IFAD still apply the GAF for Haiti. And, although not explicitly harmonized with the GAF, the CDB has also provided 100% grant financing to Haiti.

- 3.11 **In contrast, GN-2442 did not establish income ceilings for either application of the DSF or the GAF.** Country eligibility/graduation criteria were put in place in 2016, which established per capita income and creditworthiness limits to the application of the DSF and GAF. Nevertheless, for historical reasons, the income per capita eligibility criterion at the IDB is significantly higher than that at IDA and the GAF is applied to all concessional-eligible countries at the IDB.

D. The Non-Concessional Borrowing Policy (NCBP)

- 3.12 **The IDB did not adopt a policy on non-concessional borrowing (NCBP) issues following MDRI.**²⁴ The risk of moral hazard and issue of “free-riding” by other creditors, who could indirectly benefit from debt relief and concessional finance provided by the official sector without paying for it, was well recognized in the discussions and analysis prior to the approval of “Multilateral Debt Relief and Concessional Finance Reform at the Inter-American Development Bank”.²⁵ Among other things, the Board of Governors’ resolution on “Multilateral Debt Relief and Concessional Finance Reform at the Inter-American Development Bank”,²⁶ which was adopted on March 15, 2007, resolved that:

“In recognition of the IDB’s role in the region, the IDB should work with other international financial institutions, international lenders and borrowing countries to address the question of “free-riding” by lenders to countries who have received debt relief. This should include, among other activities, sharing of information on lending and borrowing volumes and patterns, advice and consultation with borrowing governments, and the discussion of potential ways to coordinate activities.”

²³ The World Bank and IMF still conduct DSAs using the LIC DSF for Guyana, Honduras and Nicaragua. But the resulting risk of debt distress does not affect the financing terms of IDA or IFAD’s concessional allocations to these countries.

²⁴ As noted in “Review of the Implementation of the Debt Sustainability Framework and Enhanced Performance-based Allocation 2017-2018. Final version” (GN-2442-68), when IFAD adopted an [NCBP](#) in early 2019, the IDB became the only institution harmonized with the DSF-GAF that did not have an NCBP.

²⁵ See for example: “Concessional Resources and Debt Relief at the Inter-American Development Bank: Background Information Prepared at the Request of the Chairman of the Board of Governors for the July 17, 2006 Meeting of the Committee of the Board of Governors” (CA-472); “Debt relief and permanency of the concessional window at the IDB” (CA-474-1), November 2006; “*IDA Countries and Non-Concessional Debt: Dealing with the “Free Rider” Problem in IDA-14 Grant-Recipient and Post-MDRI Countries*”, Resource Mobilization Department, June 2006.

²⁶ Resolution AG-3/07.

- 3.13 **In lieu of its own NCBP, since 2007 the IDB has relied on the umbrella of the IMF and World Bank’s policies relating to non-concessional borrowing.**²⁷ For example, Nicaragua’s programs with the IMF from 2007 to 2011 typically stipulated a minimum level of concessionality (35%) for external borrowing.

IV. SUCCESSES AND CHALLENGES

A. Successes

1. The Enhanced Performance-Based Allocation (EPBA) framework has worked well to date

- 4.1 **Successive IDB Management biennial reviews of the EPBA/DSF have concluded that the EPBA has worked well.**²⁸ . The experience from 2007-2020 with the exponent of 0.5 on the population variable, which was designed to favor countries with relatively small populations, has been particularly favorable.²⁹ It has enabled the IDB’s PBA to generate very “clean” allocations, whereby PBA allocations have been determined solely by the formula, without any intervention or constraints. Other IFIs’ PBAs sometimes use base allocations, minimum floors and maximum ceilings in their concessional assistance allocation systems, in order to avoid unduly small allocations to small states and unacceptably large allocations to countries with large populations (Annex II).

2. Loan blending and smooth concessionality paths

- 4.2 **As designed, the harmonization with the DSF/GAF has allowed the Bank to provide a level of concessionality that adjusts with countries’ risk of debt distress.** In general, the IDB has provided a level of concessionality that is broadly consistent with or higher than other creditors to the concessional-eligible countries.
- 4.3 **The modality of blending regular OC and Concessional OC loans has allowed the Bank to provide gradual transitions in concessionality.** The last biennial review of the EPBA/DSF noted Bolivia’s gradual and measured concessionality transition from 2007 to

²⁷ The IMF and IDA have had a clear protocol on non-concessional borrowing policy. If a low-income country has a formal IMF program in place, the IMF is the lead agency and it sets performance criteria regarding external debt limits as a function of the member country's risk of external debt distress and other relevant macroeconomic circumstances in the member country. If the country does not have an IMF program but is an IDA recipient, IDA is the lead agency, and its non-concessional borrowing policy has applied.

²⁸ “Review of the Implementation of the Debt Sustainability Framework and Enhanced Performance-based Allocation 2017-2018. Final version.” (GN-2442-68); “Review of the Implementation of the Debt Sustainability Framework and Enhanced Performance-based Allocation 2015-2016.” (GN-2442-55); “Review of the Implementation of the Debt Sustainability Framework and Enhanced Performance-based Allocation 2013-2014.” (GN-2442-48).

²⁹ In 2005, IFAD, which has one of the widest divergences in population size of any IFI using a PBA, analyzed several options to address the issue of widely diverging population sizes: 1) using caps and minimum allocations; 2) using an algebraic transformation of the population data to lessen differences; or 3) decreasing the exponent on the population term. IFAD determined that the optimal solution was to decrease the exponent and that for its membership the optimal exponent was 0.45. i.e., very close to the exponent that the IDB chose [IFAD, [Review of the Implementation of the PBA System in IFAD](#), EB2005-85-R.3, 2005].

2019.³⁰ Similarly, evidence to date suggests that the path of concessionality provided to Guyana has been consistent with the country’s underlying fundamentals as it transitions to a natural resource boom.

B. Challenges

1. One exponent in the Enhanced Performance-Based Allocation formula needs updating

4.4 **Although the EPBA has worked well to date, one aspect of the formula needs updating, in light of the growth of the overall EPBA envelope since 2007 and the reincorporation of Haiti into the EPBA.**³¹ The large negative exponent on GNI per capita in the IDB formula creates a strong bias in PBA allocations towards lower income countries and reduces the weight of performance variables relative to needs variables. A simulation of the IDB allocation of concessional resources in 2019-2020 if Haiti had been included shows that Haiti would have received more than half of the entire EPBA envelope (Table 2).³² However, if the IDB’s formula had used IDA’s exponent on GNI per capita (*-0.125*), the allocation distribution would have been very similar to the average distribution of IDA’s PBA for fiscal years 2018 and 2019.

Table 2. Simulated IDB PBA allocations 2019-2020 including Haiti

COUNTRY	IDB 2019-2020 (simulation including Haiti)	IDB 2019-2020 (using IDA exponent for GNI per capita)	IDA FY18-19
Guyana	2.7%	7.1%	8.4%
Haiti	51.5%	28.5%	27.1%
Honduras	26.1%	37.4%	35.1%
Nicaragua	19.7%	27.0%	29.4%
Total	100.0%	100.0%	100.0%

Source: Annex III and IDA country allocations for [FY18](#) and [FY19](#).

Note: IDB PBA January 1, 2019 to December 31, 2020; IDA, average allocation for July 1, 2017 to June 30, 2019.

³⁰ “Review of the Implementation of the Debt Sustainability Framework and Enhanced Performance-based Allocation 2017-2018. Final version.” (GN-2442-68), 2019.

³¹ Haiti received FSO allocations under the PBA system that was introduced in 2002. Upon introduction of the EPBA/DSF in 2007, Haiti became subject to the new DSF (for determining financial terms) but was removed from the PBA for the purposes of determining allocation volumes. Instead, the volume of resources allocated to Haiti became determined by fiat decisions (GN-2442).

³² The experience of the CDB is similar. The CDB’s PBA formula has the same exponent on GNI per capita as the IDB (-1) and in addition has a separate poverty term. Haiti’s allocation is capped rather than determined through the CDB’s PBA. As such, among the five IFIs using PBAs of which Haiti is a member, in recent years only IDA, IFAD and the GEF have provided formula-based rather than fiat-based allocations to Haiti.

4.5 **The appropriateness of such a large exponent depends in part on the size the PBA envelope relative to the size of eligible countries' absorption capacity (for which the size of GNI is a close proxy).** If the total PBA envelope is small relative to the size of the eligible countries' GNI (as the IDB's was in 2007), a large negative exponent on GNI per capita will produce a pro-poor allocation. Resources will be disproportionately steered towards the poorest countries. Although the gap between what relatively less poor countries could potentially absorb and their actual allocations will be large, the allocation could be efficient from a poverty-reduction perspective. However, if the total PBA envelope is large relative to the size of the eligible countries' GNI – as the IDB's PBA envelope has become in recent years -- a large negative exponent on GNI per capita will lead to imbalances. Absorption capacity is correlated with economic size – larger economies can absorb more resources. A formula that tilts too heavily in the direction of low income will likely lead to overly large allocations to the poorest countries (that cannot be absorbed efficiently) and under-allocations to relatively less poor countries that could productively absorb more resources. Although the over-allocation issue could be resolved through the use of a cap or fiat limit, the best option from a technical perspective would be to simply adjust the GNI per capita exponent to better align PBA allocations with absorption capacity (Table 3).

Table 3. Annual PBA allocations 2019-2020 as % of GNI (2018)

COUNTRY	IDB 2019-2020 (Haiti allocation simulated)	IDB 2019-2020 (using IDA exponent for GNIpc)	IDA FY18-19
Guyana	0.35%	0.91%	0.78%
Haiti	2.75%	1.52%	1.05%
Honduras	0.56%	0.80%	0.54%
Nicaragua	0.72%	0.98%	0.78%
Unweighted average	1.09%	1.05%	0.79%

Source: Annex III and IDA country allocations for [FY18](#) and [FY19](#).

Note: IDB PBA allocations includes only allocation of concessional resources. Blending of OC resources is not included, so total allocations would be a higher share of GNI.

4.6 **Viewing the PBA from a dynamic perspective over time rather than from a static perspective suggests an additional problem with a large negative exponent on GNI per capita.** Countries that are successful and experience relatively rapid economic growth (as is hoped for under a sound policy and institutional framework) will be penalized via successively smaller allocations. Consequently, as IDA has noted, a large negative exponent on GNI per capita can act as a tax on growth.³³

³³ IDA, "[IDA's Performance-Based Allocation System Update on Outstanding Issues](#)", February 2004.

2. The Debt Sustainability Framework/Grant Allocation Framework affects allocation volumes

- 4.7 **Unlike any other MDB, at the IDB the DSF/GAF significantly affects the overall volume of resources allocated to a concessional-eligible country.** Although the EPBA/DSF was intended to be a performance-driven allocation framework, in practice the volume of overall allocations have tended to be more sensitive to a country's risk of debt distress than to policy and portfolio performance. Hence, the PBA is less important relative to the DSF at the IDB than at other MDBs. At the time of the debt relief process (GN-2442), such volume adjustments were seen as contributing to debt sustainability. However, more recently that contribution has been questioned, with concern that sharp downward adjustment of IDB lending levels might lead countries to rely on more expensive creditors, thereby in practice actually weakening rather than strengthening debt sustainability. Concessional-eligible countries have been particularly concerned with the magnitude of adjustments in total allocation volumes when the risk of debt distress increases.³⁴

3. Absence of income and vulnerability considerations in the determination of concessionality

- 4.8 **A key weakness of the current EPBA/DSF framework is the absence of income and vulnerability considerations in the determination of the concessionality of concessional-eligible countries biennial concessional resource allocations.** Since 2007, the risk of debt distress has been *de jure* the sole determinant of concessionality. For the period 2007-2020, this was not a problem because other variables that are important to member countries – such as per capita income and vulnerability/fragility -- have been conveniently correlated with the risk of debt distress. However, it is likely that such convenient correlations will not always hold in the future. This raises the risk that a framework that *de jure* continues to maintain the risk of debt distress as the sole determinant of concessionality may not be fully aligned with shareholder preferences.

a. Univariate framework versus multivariate shareholder preferences

- 4.9 **The current framework which ties concessionality to a sole variable – the risk of debt distress – appears to be unduly narrow and only partially reflects member country preferences.** In addition to the risk of debt distress, historically member countries have placed weight on per capita income considerations³⁵ and more recently have called for vulnerability considerations to be incorporated in the concessional framework. Member country preferences would be better represented by a framework that puts some weight on all three variables (risk of debt distress, per capita income, and vulnerability) rather than exclusively on only one of these variables. Because per capita income and vulnerability were substantially correlated with the risk of debt distress for the period 2007-2020, the

³⁴ This was particularly the case for the “Proposal for the Allocation of Concessional Resources 2019-2020” (GN-2442-57), where the total allocations to Honduras and Nicaragua were reduced by one-third due to both countries moving from the “moderate-substantial space” risk of debt distress rating to the “moderate-limited space” rating.

³⁵ Per capita income and vulnerability (small economic size) were the principal determinants of the level of concessionality from 1972-2006. Moreover, in 2007 the regulations of the IDB GRF restricted the provision of grants to Haiti, i.e., not to all concessional-eligible countries at high risk of debt distress (GN-2442-11).

limitations of the current framework's dependence on a single variable were not exposed prior to 2020.

b. Application of GAF to relatively high-income levels

- 4.10 **The unique position of the IDB as the only MDB to apply the GAF to income levels above the IDA operational cut off (US\$1,185 for fiscal year 2021) but below twice the IDB per capita income threshold for eligibility to concessional resources (US\$3,041) is likely unsustainable.** The large range of income to which the GAF is applied exposes the Bank to several risks. First, it provides scope for the possibility that the degree of concessionality provided to eligible countries in an allocation could be positively correlated with income per capita, in contrast to the historical inverse correlation whereby lower income countries receive higher levels of concessionality. This is a meaningful risk (see section d.). Second, it exposes the IDB, more than any other MDB, to the *free rider* and incentive/moral hazard issues of the GAF. Non-DSF/GAF-harmonized creditors have incentives not to apply the GAF, which is costly, but instead to *free ride* on debt relief and ongoing concessional resources provided by other creditors, thereby, in effect, receiving a cross-subsidy to their lending. The other four DSF/GAF-harmonized creditors are not exposed to this risk in countries with an income level above the IDA operational cut-off. The DSF-GAF also creates a degree of moral hazard. In contrast to commercial credit, the DSF-GAF suffers from “perverse incentives”. Policy actions that increase the risk of debt distress – running large fiscal deficits over a prolonged period and taking on substantial amounts of high-cost debt – get “rewarded” by an increase in the concessionality of future flows. Actions to reduce the risk of debt distress – fiscal discipline and the avoidance of non-concessional debt – are “punished” with a reduction in the level of concessionality of future flows. The IDB is unique in being exposed to these risks in countries with a per capita income level above the IDA operational cut-off.

c. Ambiguous treatment of countries at high risk of debt distress

- 4.11 **The Bank's concessional framework lacks a harmonized approach on the concessionality levels for countries at high risk of debt distress.** On the one hand, when the IDB harmonized with the DSF-GAF in February 2007 (GN-2442), the IDB adopted the central GAF principle of adjusting its financing composition based on the risk of debt distress and, accordingly, assigned Haiti an allocation of 100% grants for the period 2007-2009, based on its high risk of debt distress at the time. The Bank established the IDB Grant Facility in 2007 in order to be able to provide Haiti with such grants. On the other hand, the regulations for the IDB Grant Facility, approved by the Board of Executive Directors in May 2007 (GN-2442-11), limited country eligibility to the GRF to Haiti rather than to countries rated as high risk of debt distress. Consequently, the highest level of concessionality is already in practice closed to countries with an income level higher than the IDA income operational cut-off. In the absence of per capita income level cut-offs on the application of the DSF-GAF in GN-2442, the GRF Regulations in effect represented a second-best mechanism for specifying such per capita income level restrictions. For the period 2007-2020, Haiti was the only Bank member country that was rated as at high risk of debt distress. However, in the future if another concessional eligible country were to be rated as at high risk of debt distress, the concessional framework would not be providing a

harmonized approach regarding the level of concessionality in subsequent biennial allocations.

d. 2017 Revision to Debt Sustainability Framework for Low-Income Countries

- 4.12 **In September 2017 the Executive Boards of the IMF and World Bank approved the fourth revision of the Low-Income Country Debt Sustainability Framework (DSF) since its introduction in 2004.**³⁶ As signaled in the “Review of the Implementation of the Debt Sustainability Framework and Enhanced Performance-based Allocation 2017-2018. Final version” (GN-2442-68), one of the methodological reforms intended to improve the accuracy of the framework could have operational implications for the IDB, particularly once Haiti is reincorporated into the EPBA/DSF framework. The DSF compares projected debt burden indicators against thresholds above which the probability of debt distress rises above a level considered tolerable. Since the quality of a country’s policies and institutions has been shown to be a key determinant of the debt levels that a country can safely sustain,³⁷ ever since its introduction in 2004, the DSF has used three different threshold levels depending on whether a country is classified as having “strong”, “medium” or “weak” policies and institutions.³⁸ From 2004-June 2018, the classification of countries into the strong, medium and weak debt carrying capacity groupings relied exclusively on the World Bank’s Country Policy and Institutional Assessment (CPIA). However, following the 2017 Review the country classifications are now determined by a **composite indicator** covering the CPIA, reserve coverage, remittances, economic growth, and world growth.³⁹ The weight of the CPIA was expected to decline from 100 percent to below 50 percent.
- 4.13 **Country CPIA scores have traditionally been positively correlated with per capita income and negatively correlated with measures of fragility.** Hence, through its effect on the debt carrying thresholds, the CPIA has transmitted some correlation between per capita income and fragility to countries’ assessed risk of debt distress. For DSF-harmonized MDBs, such as the IDB, the result has been that although *de jure* the risk of debt distress has been the sole determinant of concessionality levels, in practice poorer and more fragile countries have tended to receive higher concessionality levels.
- 4.14 **These correlations have meant that, when determining appropriate concessional levels for eligible borrowing member countries, to date member country shareholders have not faced trade-offs regarding the risk of debt distress and other variables such as per capita income and fragility.** With the introduction of the composite indicator to determine debt carrying capacity thresholds, such correlations might break down. In

³⁶ The revised framework, incorporating a new Excel template for the debt sustainability analyses and a new guidance note, came into effect in July 2018 and the “Proposal for the Allocation of Concessional Resources 2019-2020” (GN-2442-57) was prepared using the revised framework.

³⁷ Kraay, A. and V. Nehru (2006) “When is External Debt Sustainable?”, The World Bank Economic Review, August 2006.

³⁸ IMF and IDA (2004) “Debt Sustainability in Low-Income Countries -- Proposal for an Operational Framework and Policy Implications”, Washington, D.C.

³⁹ IMF (2018) “[Guidance Note on the Bank-Fund LIC DSF](#)”, Washington, D.C.

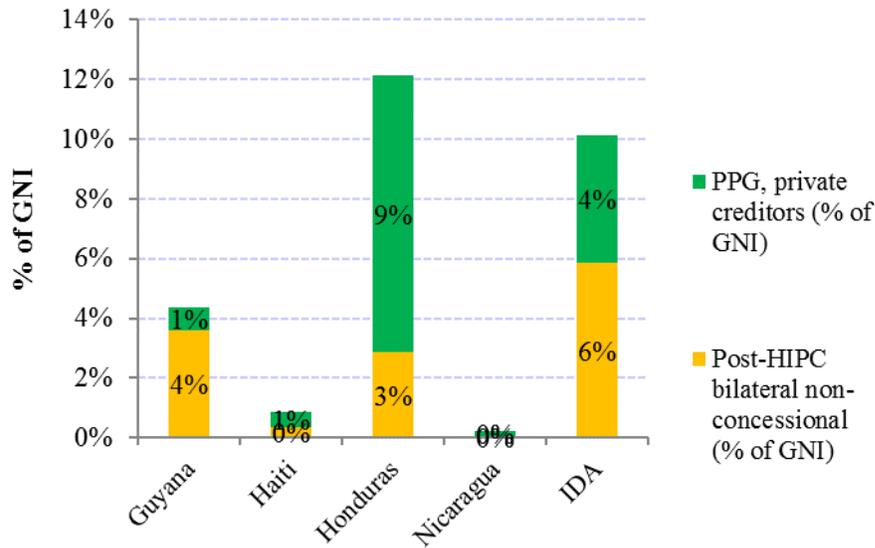
particular, relatively poor and fragile countries that score highly in terms of remittances and international reserves may be rated as having a lower risk of debt distress under the revised methodology. Consequently, continued reliance on the risk of debt distress as the sole determinant of concessionality might lead to a situation where the degree of concessionality the Bank provides is lower for poorer and more fragile countries than for less poor and less vulnerable countries (in contrast to the pattern from 1972-2020).

4. Continued absence of a policy regarding non-concessional borrowing⁴⁰

- 4.15 **An absence of an explicit policy or framework on non-concessional borrowing issues is likely to be less tenable in the future for two reasons.** First, the “coverage” from the IMF debt limits and IDA NCBP has diminished over time. IDB concessional-eligible member countries have tended to have fewer IMF disbursing programs in recent years, and therefore less coverage under the IMF Debt Limits Policy. In addition, growing incomes per capita have led to graduation from “IDA-only” status to “IDA-blend” status, with the result that they therefore were no longer subject to IDA’s “Non-Concessional Borrowing Policy”. After 2015, Haiti was the only IDB-member country covered by IDA’s “Non-Concessional Borrowing Policy”.
- 4.16 **Second, the international financing context has changed significantly since the multilateral debt relief processes and the phenomenon of non-concessional borrowing has grown significantly since 2007.** In the wake of the 2008-2009 global financial crisis, quantitative easing monetary policies in the principal central banks have underpinned a growing expansion of private credit, mostly in the form of international bonds, to countries that had benefitted from the HIPC/MDRI debt relief processes and which continue to be eligible to concessional multilateral finance. In addition, non-concessional lending by non-Paris Club bilateral creditors has expanded since 2007.⁴¹ Three of the IDB’s concessional-eligible countries have less non-concessional external public debt than the IDA country average and Haiti and Nicaragua have very little post-HIPC non-concessional debt (Figure 2). Nevertheless, Honduras has increasingly tapped the international bond markets since 2013 and the trend of increasing private sector credit to concessional-eligible countries is expected to continue to grow over time.

⁴⁰ For the purposes of this document, “Non-concessional borrowing” is understood as borrowing with an interest rate higher than the [discount rate](#) set by the IMF for calculating concessionality. Since 2013, the discount rate has been 5%.

⁴¹ IMF (2018) [Macroeconomic Developments and Prospects in LIDCs](#), Washington, D.C.; and Prizzon, A. and S. Mustapha (2014) [Debt Sustainability in HIPC in a New Age of Choice](#), Overseas Development Institute, London, U.K.

Figure 2. Non-concessional borrowing as % of GNI (2019)

Source: VPC based on [International Debt Statistics 2021](#), World Bank; and GNI from World Development Indicators, World Bank.

- 4.17 **Non-concessional borrowing by recipients of concessional resources presents providers of concessional resources with a dilemma.** On the one hand, a transition to increased use of non-concessional borrowing is a natural part of the development process, as countries' incomes and creditworthiness rise. On the other hand, the provision of concessional resources – which are intended to help a poor and vulnerable country – in effect simultaneously provide a cross-subsidy to any creditor that is providing non-concessional resources. Consequently, there is a fiduciary responsibility issue for an institution when asking countries borrowing on ordinary terms to pay for concessional assistance that provides a cross-subsidy to non-concessional creditors. If countries are paying interest rates of 6-8 percent on international bonds, it is unclear why they would be unable to pay ordinary MDB lending terms of 2-4 percent.
- 4.18 **Countries have a sovereign right to choose their creditors and there is an increasing array of potential creditors, even for countries that needed deep debt relief 15 years ago.** It is neither feasible nor correct to expect that DSF-GAF creditors should or would be able to limit member countries' non-concessional borrowing. Indeed, as noted above, it is natural that concessional-eligible countries eventually transition to borrowing on non-concessional terms. In this respect, MDBs providing concessional assistance need a way of protecting the fiduciary interests of all members of the cooperative while avoiding punitive measures on concessional-eligible countries as they transition over time into increased volumes of non-concessional borrowing.
- 4.19 **Since mid-2020, IDA has replaced the NCBP with a [Sustainable Development Finance Policy of the International Development Association](#) (SDFP).** The SDFP has two pillars: (i) a Debt Sustainability Enhancement Program (DSEP); and (ii) a Program of Creditor Outreach (PCO). Unlike the previous NCBP, the SDFP will apply to all IDA-eligible countries. Under the DSEP, IDA will screen all IDA countries annually to determine those countries for which a Performance and Policy Action (PPA) plan towards transparent and

sustainable borrowing will need to be defined and implemented. Progress in implementing PPAs will be assessed annually. Countries that do not satisfactorily implement their PPA in one year will have 10 percent (if at medium risk of debt distress) or 20 percent (if at high risk of debt distress) of their country allocation for the year set aside. If performance on a country's PPA is lagging for two years in a row, the amount of the allocation set aside in year 1 is automatically lost. Through the PCO, IDA will seek to promote stronger collective action, greater debt transparency and closer coordination among borrowers and creditors to mitigate debt-related risks. Under the PCO, IDA has developed [core principles of sustainable financing](#), which establish principles for international financing institutions related to: (i) consideration of debt vulnerability in resource allocation decisions; (ii) creditor coordination; (iii) information sharing and transparency; and (iv) financial innovation.

- 4.20 **The IDB has supported and been harmonized with the bulk of the core principles of sustainable financing since 2007.** Management will continue such harmonization. While supporting the objectives towards transparent and sustainable borrowing, Management does not view operational harmonization with the DSEP as feasible or desirable. Unlike most parts of the PBA/DSF framework, the DSEP has a time-related aspect (linked to IDA's 3-year replenishment cycles) that would be difficult to manage in the IDB's biennial cycle. Furthermore, introducing set asides into biennial allocations would compromise the programming flexibility within the two-year biennial allocation periods that concessional-eligible countries and country departments value highly. In addition, Management considers that alignment with PPAs would introduce additional bureaucratic costs that run counter to efforts to reduce business and transactional costs. Finally, while improvements in transparency and debt management have merit, the DSEP would not directly address the fiduciary issue for the IDB related to non-concessional borrowing.

V. PROPOSED ADJUSTMENTS TO THE ENHANCED PERFORMANCE-BASED ALLOCATION/DEBT SUSTAINABILITY FRAMEWORK

- 5.1 **The core of the Bank's concessional resources framework (the EPBA/DSF)⁴² broadly has performed well in the fourteen years since its adoption.** However, a variety of changes in the international context -- including changes in the international financing landscape and methodological changes in the underlying frameworks -- as well as lessons learned, have generated a need to update certain aspects of the framework. This is particularly the case for parts of the concessional framework where the IDB diverged operationally from other MDBs in its application of the international framework.
- 5.2 **The three Proposed adjustments are intended to update the core of the Bank's concessional resources framework (the EPBA/DSF) in order to address changes and lessons learnt since the current framework was introduced in 2007.** These adjustments will address the challenges outlined in chapter IV.B. and will serve to implement the reincorporation of Haiti into the PBA system. The adjustments will tailor both the volume and financing terms better to the situation of individual concessional resource-eligible

⁴² For practical and harmonization purposes with other IFIs (IDA/AfDB/AsDB/CDB/IFAD/GEF), the term "Performance-Based Allocation (PBA)" may be used when referring to the "Enhanced Performance-Based Allocation (EPBA)".

countries. The changes would rebalance the framework to: (i) align relative allocation volumes better with the economic size, absorption capacity and financing needs of the countries; and (ii) ensure that relative levels of concessionality stay aligned with levels of per capita income and vulnerability.

- 5.3 The DSF/GAF will not be discontinued; however, the IDB's application of the DSF/GAF will be modified so as to: (i) allow the IDB's continued harmonization with the DSF/GAF in a more sustainable manner; (ii) introduce additional variables that the Board of Executive Directors now considers relevant for the determination of financing terms/concessionality; and (iii) update the framework to take into account changes in the international financial landscape since 2007 and changes in the policy frameworks of other multilateral institutions with which the IDB is harmonized.

1. Harmonize the PBA GNI per capita exponent with IDA

- 5.4 **The exponent on GNI per capita in the PBA formula would be reduced from -1 to -0.125.** It would thus become harmonized with that of IDA and of the AfDB. No other element of the PBA formula will be changed.

Current PBA formula

$$\text{Country allocation score} = \text{POP}^{0.5} \times \text{GNIpc}^{-1} \times [0.7 \times \text{CIPE} + 0.3 \times \text{PPI}]^2$$

$$\text{Country allocation share} = \frac{\text{Country allocation score}}{\text{Sum of allocation scores of all eligible countries}}$$

Proposed PBA formula

$$\text{Country allocation score} = \text{POP}^{0.5} \times \text{GNIpc}^{-0.125} \times [0.7 \times \text{CIPE} + 0.3 \times \text{PPI}]^2$$

$$\text{Country allocation share} = \frac{\text{Country allocation score}}{\text{Sum of allocation scores of all eligible countries}}$$

2. Expand the definition of the PBA envelope to cover the entire resource allocation to concessional-eligible countries

- 5.5 **The definition of the PBA envelope will be expanded to cover the entire allocation of resources in a biennial resource allocation to countries eligible for concessional resources.** The practice of blending resources of differing concessionality levels (e.g., Concessional Ordinary Capital (COC) and Ordinary Capital (OC)) will continue. The blending will simply be a division of a country's EPBA allocation in the proportion of the

blend.⁴³ Consequently, the role of the DSF/GAF in affecting the volume of countries' allocations of resources will terminate and henceforth the DSF/GAF will affect only the financial terms or concessionality of the allocation. As such, there will be a clear separation between the role of the PBA, on the one hand, to determine the allocation and volume of resources, and the role of the DSF/GAF, on the other hand, to affect the concessionality of PBA allocations. This adjustment will address the challenges discussed in paragraphs 3.9 and 4.7. It will also harmonize the IDB with the practices of all the other IFIs using a PBA and the DSF/GAF.

3. Introduce additional variables for determining concessionality

- 5.6 **The DSF risk of debt distress and GAF will be retained as a major determinant of concessionality but will be supplemented by three additional variables.** These additional variables will be: (i) relative poverty (as determined by an inverted GNI per capita scale); (ii) an index of vulnerability; and (iii) an index of non-concessional borrowing. The four variables will be combined using a points system, which will then be mapped into a proposed composition of financing (blending) for each country's PBA allocation (Annex IV).⁴⁴
- 5.7 **Three variables will contribute to a country's combined concessionality points score: (i) low GNI per capita; (ii) vulnerability; and (iii) the risk of debt distress.** Concessionality points from GNI per capita will be calculated on a 0-100 scale by subtracting a country's latest GNI per capita from the GNI per capita threshold established in 2016 (US\$2,834):

$$\text{MAX} \left[0, \left[\frac{(2,834 - \text{GNI per capita } i)}{2,834} * 100 \right] \right]$$

- 5.8 **Consequently, concessionality points would decline as GNI per capita increases.** A country with a low GNI per capita will receive high concessionality points while countries with a GNI per capita above US\$2,834 would receive zero concessionality points from this variable.
- 5.9 **Concessionality points from vulnerability will be calculated by using a vulnerability index.** This index will be a composite index using six existing indices already publicly available and external to the Bank covering different facets of vulnerability (small population size, island or landlocked status, remoteness from world markets, exposure to

⁴³ For example, if country A receives an EPBA allocation of US\$200 million per annum and its combined concessionality points score indicate a financing blend of 30% COC and 70% OC, then country A's annual allocation will be US\$60 million COC and US\$140 million OC. Individual blended loans will not be affected by the Proposal and will continue to follow blending according to the relevant biennial allocation.

⁴⁴ This mirrors the current system in the sense that the relevant variable (currently only the risk of debt distress) maps to a proposed composition of COC and OC financing and hence indirectly to a level of concessionality in concessional resource allocations. The proposed change is for four variables instead of one to determine the composition of financing.

natural hazards, vulnerability to climate change, and fragility). Considerations regarding the selection of these indices are elaborated in Annex VII. More vulnerable countries, as reflected by higher scores on the vulnerability index, will receive more concessionality points (per Annex VIII).

- 5.10 **Concessionality points from the risk of debt distress** will be assigned by following the percentage of Concessional Ordinary Capital (COC) in the “Proposal for the Allocation of Concessional Resources 2019-2020” (GN-2442-53) (Table 4):

Table 4. Concessionality points from the risk of debt distress

Risk of debt distress in Debt Sustainability Analysis under the LIC DSF	Concessionality points
High risk of debt distress or in debt distress	100
Moderate risk of debt distress (limited space to absorb shocks)	65
Moderate risk of debt distress (some space to absorb shocks)	50
Moderate risk of debt distress (substantial space to absorb shocks)	40
Low risk of debt distress	30

- 5.11 **The fourth concessionality variable – the extent of non-concessional borrowing --** will serve as a negative contributor to a country’s combined concessionality score. The extent of non-concessional borrowing will be measured as the sum of public and publicly guaranteed external debt from private creditors and non-concessional bilateral creditors in US dollars divided by that country’s gross national income (GNI) (Annex IX). The concessionality points score on non-concessional borrowing will be the same as the share of non-concessional borrowing/GNI, i.e., non-concessional borrowing amounting to 5.2% of GNI will be scored as 5.2 points.
- 5.12 **Concessionality points from the three contributing variables (GNI per capita, vulnerability and risk of debt distress) will be summed and divided by three to average their contribution of concessionality points.** The score from non-concessional borrowing will be subtracted from this average of the three concessionality contributing variables in order to generate a **combined concessionality points score** (Annex V, column F). The combined concessionality points score will be mapped into a proposed financing blend and level of concessionality for each country’s PBA allocation (Annex IV). By design, the highest levels of concessionality for PBA allocations will be accorded to countries with: lower incomes, a high level of vulnerability, higher risk of debt distress, and lower levels of non-concessional borrowing.
- 5.13 **There would be numerous advantages to adding income, vulnerability and non-concessional considerations to the risk of debt distress as determinants of the concessionality of PBA allocations.** First, the broader framework would eliminate the risk of concessionality levels being positively correlated with income per capita and negatively

correlated with vulnerability (arising from external methodological changes). Second, the framework would resolve the ambiguity regarding treatment of countries at high risk of debt distress, in a manner that is consistent both with the 2007 harmonization with the DSF/GAF and the existing regulations governing the IDB GRF (GN-2442-11). Third, the incorporation of variables that are more structural than the risk of debt distress would help to stabilize concessionality levels over time and contribute to smooth concessionality transitions in the future. Fourth, the framework would allow the Bank to address non-concessional borrowing in a manner that is respectful of concessional-eligible countries' sovereignty and supportive of their natural development finance trajectories while protecting the fiduciary interests of non-concessional Bank member countries. Fifth, the broader framework would substantially reduce the risk to the Bank from the DSF-GAF's "perverse incentives" and moral hazard (to which the IDB would otherwise be exposed to a greater degree than any other MDB). The combination of providing higher concessionality for higher risk of debt distress and subtracting concessionality points with increasing non-concessional borrowing allows a distinction to be made between countries at high risk of debt distress for structural reasons or due to an exogenous shock and countries at high risk of debt distress associated with high levels of non-concessional borrowing (Annex VI).

- 5.14 **Broadening the framework for determining concessionality would allow the IDB to remain harmonized with DSF-GAF in a more sustainable way.** The IDB's application of the DSF-GAF to countries under the IDA operational income per capita cut-off (currently only Haiti) would be more diluted than that of other DSF-GAF-harmonized IFIs. However, the IDB would be the only IFI that allows some role for the GAF for countries with income per capita higher than the IDA operational cut-off (including Guyana, Honduras, and Nicaragua).

VI. RECOMMENDATIONS

- 6.1 Based on the information and analysis provided in this document, Management recommends that the Board of Executive Directors approve the proposed adjustments to the EPBA/DSF framework described in Section V of the document as well as Annexes IV, VI, VII and IX attached hereto.

ANNEX I
PBA FORMULAS COMPARED

	Needs variables	Performance variables
MDBs		
AfDB	$POP^{1.0} \times GNIpc^{-0.125} \times AIDI^{-0.25}$	$(0.20CPIA_{A-C} + 0.58CPIA_D + 0.06CPIA_E + 0.16PORT)^{4.125}$
AsDB	$POP^{0.6} \times GNIpc^{-0.25}$	$[(ADB_CPIA_{A-C})^{0.7} \times (ADB_CPIA_D)^1 \times PORT^{0.3}]^2$
CDB	$LogPOP \times POOR^{0.1} \times GNIpc^{-1} \times VUL^2$	$[0.7CD_CPIA + 0.3PORT]^2$
IDA	$POP^{1.0} \times GNIpc^{-0.125}$	$(0.24CPIA_{A-C} + 0.68CPIA_D + 0.08PORT)^3$
IDB	$POP^{0.5} \times GNIpc^{-1}$	$[0.7CIPE + 0.3PORT]^2$
Proposed IDB	$POP^{0.5} \times GNIpc^{-0.125}$	$[0.7CIPE + 0.3PORT]^2$
Specialized agencies		
GEF	$GBI^{0.8} \times GDP^{-0.12}$	$(0.65CEPIA + 0.15BFI + 0.2PORT)^1$
IFAD	$Rural\ POP^{0.405} \times GNIpc^{-0.265} \times IVI^{0.95}$	$(0.35RSP + 0.65PORT)^1$

Notes: Variables: POP = Population; GNIpc = GNI per capita; AIDI: Africa Infrastructure Development Index; VUL = Country Vulnerability (CDB); IVI (IFAD Vulnerability Index); CIPE= Country Institutional and Policy Evaluation (IDB); CPIA = Country Policy and Institutional Assessment; RSP= Rural Sector Performance rating on policies and institutions for rural development (IFAD); PORT= Portfolio rating; CEPIA: The World Bank CPIA environmental variable; BFI=Broad Framework Indicator.

$CPIA_{A-C}$ = CPIA clusters for economic management, structural policies and policies for social inclusion/equity.

$CPIA_D$ = CPIA cluster for public sector management and institutions.

$CPIA_E$ = CPIA cluster for infrastructure and regional development policies.

GBI: The Global benefits Index is calculated separately for the two focal areas: The GBI for Biodiversity is $0.8 \times TERRESTRIAL\ BIODIVERSITY + 0.2 \times MARINE\ BIODIVERSITY$ (Terrestrial Biodiversity is defined as $0.55 \times$ represented species + $0.20 \times$ threatened species + $0.15 \times$ represented eco-regions + $0.10 \times$ threatened eco-regions; and Marine Biodiversity is defined as represented marine species. The GBI for Climate change is defined as Baseline GHG emissions X carbon intensity adjustment factor.

Sources: AfDB: [ADF country resources allocation](#); AsDB: [Concessional Assistance Policy](#); CDB unpublished presentation on SDF8; IDA: [IDA 18 Towards 2030 Investing in Growth, Resilience and Opportunity](#); IDB: GN-2442; The GEF: [Updating the System for a Transparent Allocation of Resources \(STAR\)](#) and [STAR Policy Guidelines](#) (2018).

ANNEX II
USE OF BASE ALLOCATIONS, MINIMUM FLOORS AND MAXIMUM CEILINGS IN PBAS

	Minimum/base allocations	Maximum allocation constraints
MDBs		
AfDB	UA 5 million per country per year	Individual ADF country allocations are capped at 10% of PBA available resources
AsDB	ADF IX-ADF 11 US\$3 million per country/year; ADF 12 US\$6 million per country/year; in ADF 13 base allocations will be removed and a vulnerability premium will be provided to small island states.	Group B countries with a PBA country allocation share greater than 14% receive 14% plus half of the amount above the 14% threshold.
CDB		Haiti is subject to a fixed ceiling and does not get a formula-based allocation.
IDA	SDR 15 million per country per year	None
IDB	None	None
Specialized agencies		
GEF	\$6 million for LDCs; \$4 million for non-LDCs	
IFAD	\$1 million	5% of total allocated

Sources: AfDB [ADF country resources allocation](#); AsDB: [Concessional Assistance Policy](#); [ADF 12 Donors Report](#) and [ADF 13 Donors Report draft](#); CDB [SDF Annual Report 2017](#) ; IDA [IDA 18 Towards 2030 Investing in Growth, Resilience and Opportunity](#); IDB GN-2442; GEF: [Updating the System for a Transparent Allocation of Resources \(STAR\)](#); IFAD [IFAD's Performance-based Allocation System](#).

ANNEX III
A SIMULATION OF THE EPBA 2019-2020 INCLUDING HAITI

CURRENT FORMULA (WITHOUT EXPONENT REFORM)					
COUNTRY	Guyana	Haiti	Honduras	Nicaragua	Total
Total population 2017	777,859	10,982,366	9,265,067	6,217,581	27,242,873
GNI per capita (US\$) 2017	4,460	760	2,250	2,130	
Performance indicator (1-6 scale) = [0.7*CIPE + 0.3 PPI]	3.53	3.26	4.17	3.90	
CIPE (1-6 scale)	3.27	2.81	3.38	3.21	
Portfolio (PPI) (1-6 scale)	4.15	4.31	6.00	5.49	
Population exponent	0.5	882	3,314	3,044	2,494
GNI p/c exponent	-1.0	0.00022	0.00132	0.00044	0.00047
Performance exponent	2.0	12.5	10.6	17.4	15.2
Allocation value	2.5	46.3	23.5	17.8	90.0
Allocation shares EPBA	2.74%	51.45%	26.07%	19.73%	100%
Yearly concessional resource allocations (US\$ million)	13.0	244.7	124.0	93.9	475.7
Annual allocation/GNI (%)	0.35%	2.75%	0.56%	0.72%	1.09%

WITH EXPONENT REFORM					
COUNTRY	Guyana	Haiti	Honduras	Nicaragua	Total
Total population 2017	777,859	10,982,366	9,265,067	6,217,581	27,242,873
GNI per capita (US\$) 2017	4,460	760	2,250	2,130	
Performance indicator (1-6 scale) = [0.7*CIPE + 0.3 PPI]	3.53	3.26	4.17	3.90	
CIPE (1-6 scale)	3.27	2.81	3.38	3.21	
Portfolio (PPI) (1-6 scale)	4.15	4.31	6.00	5.49	
Population exponent	0.5	882	3,314	3,044	2,494
GNI p/c exponent	-0.125	0.34981	0.43641	0.38105	0.38367
Performance exponent	2.0	12.5	10.6	17.4	15.2
Allocation value	3,848.0	15,366.5	20,128.4	14,521.2	53,864.2
Allocation shares EPBA	7.14%	28.53%	37.37%	26.96%	100%
Yearly concessional resource allocations (US\$ million)	34.0	135.7	177.8	128.2	475.7
Annual allocation/GNI (%)	0.91%	1.52%	0.80%	0.98%	1.05%

1/ In order to present a simulation consistent with the actual allocation in 2019-2020, the actual EPBA envelope of US\$230.9 million was scaled up to US\$475.7 million to compensate for the introduction of Haiti in the simulation and to maintain the allocation to Guyana, Honduras, and Nicaragua at US\$230.9 million in the first scenario.

ANNEX IV

PROPOSED CONCESSIONALITY POINTS AND FINANCING COMPOSITION MATRIX

Range of combined concessionality points	Proposed financing composition			Estimated Concessionality (December 2020)	Possible country characteristics	With scores as of December 2020, relevant for:
	Grant share	Concessional OC share	Regular OC share			
>70	100%	0%	0%	100.0%	GNI per capita below US\$1,185; top quartile of vulnerability; NCB <5% of GDP; high risk of debt distress	Haiti at high risk of debt distress
65<X<70	0%	100%	0%	81.5%	GNI per capita below US\$1,185; top quartile of vulnerability; NCB <5% of GDP; moderate risk of debt distress (limited space)	Haiti at moderate risk of debt distress (limited space)
60<X<65	0%	90%	10%	75.8%	GNI per capita below US\$1,185; top quartile of vulnerability; NCB <5% of GDP; moderate risk of debt distress (some space)	Haiti at moderate risk of debt distress (some space)
55<X<60	0%	80%	20%	70.2%	GNI per capita below US\$1,185; top quartile of vulnerability; NCB <5% of GDP; moderate risk of debt distress (substantial space)	Haiti at moderate risk of debt distress (substantial space); Nicaragua at high risk of debt distress
50<X<55	0%	70%	30%	64.5%	Low income and high vulnerability but low risk of debt distress; or intermediate income and vulnerability and high risk of debt distress, with low NCB.	Haiti at low risk of debt distress
45<X<50	0%	65%	35%	61.6%	Intermediate levels of income, vulnerability, risk of debt distress and NCB	Nicaragua at moderate risk of debt distress (limited space)
40<X<45	0%	55%	45%	56.0%	Intermediate levels of income, vulnerability, risk of debt distress and NCB	Nicaragua at moderate risk of debt distress (some space); Guyana and Honduras at high risk of debt distress
35<X<40	0%	50%	50%	53.1%	Intermediate levels of income, vulnerability, risk of debt distress and NCB	Nicaragua at moderate risk of debt distress (substantial space)
30<X<35	0%	45%	55%	50.3%	Wide diversity of intermediate combinations. But excludes low income countries and unlikely for countries with heavy NCB.	Nicaragua at low risk of debt distress.
25<X<30	0%	40%	60%	47.5%	Wide diversity of intermediate combinations. But excludes low income countries and unlikely for countries with heavy NCB.	Guyana and Honduras at moderate risk (limited space)
20<X<25	0%	35%	65%	44.6%	Intermediate levels of income and vulnerability, with lower risk of debt distress; NCB>10% of GDP	Guyana and Honduras at moderate risk (some space and substantial space)
15<X<20	0%	30%	70%	41.8%	Intermediate income and vulnerability, with low risk of debt distress/OR Higher income and low vulnerability, with moderate risk of debt distress (substantial space); NCB>10% of GDP	Guyana and Honduras at low risk of debt distress
10<X<15	0%	20%	80%	36.1%	GNI per capita above US\$2,834; bottom quartile of vulnerability; moderate risk of debt distress (substantial space); NCB>10% of GDP	
<10	0%	10%	90%	30.5%	GNI per capita above US\$2,834; bottom quartile of vulnerability; low risk of debt distress; NCB>10% of GDP	
N/A	0%	0%	100%	24.8%	BMC not eligible for concessional resources	BMC not eligible for concessional resources

ANNEX V

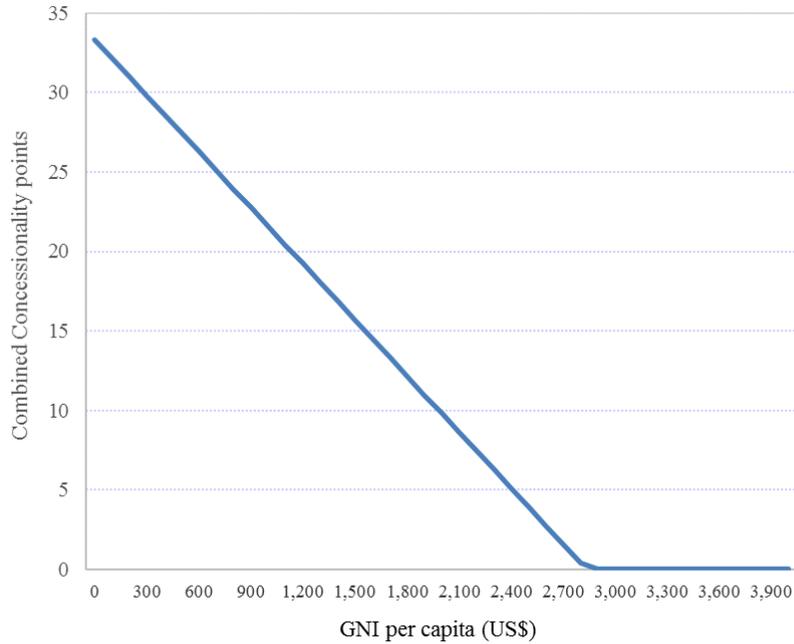
2020 CONCESSIONALITY POINTS SCORING UNDER PROPOSED METHODOLOGY

Countries	GNI capita (\$)		Vulnerability	DSF Risk of debt distress			Average of concessionality contributors	Non-concessional borrowing		Combined Concessionality Points
	Value	Points		Risk	Moderate Risk Granularity	Points		Points	% of GDP	
	A		B	C			D = (A+B+C)/3	E		F = D-E
	Value	Points	Points	Risk	Moderate Risk Granularity	Points	Points	% of GDP	Points	=
Haiti	790	72.1	63.0	Low	Not applicable	30	55.0	0.9%	0.9	54.2
Nicaragua	1,910	32.6	41.8	Moderate	Limited space	65	46.5	0.2%	0.2	46.3
Honduras	2,390	15.7	41.3	Moderate	Some space	50	35.6	12.1%	12.1	23.5
Bahamas	31,780	0.0	55.4			0	18.5			18.5
Guyana	5,180	0.0	38.6	Low	Not applicable	30	22.9	6.1%	6.1	16.8
Trinidad and Tobago	16,890	0.0	47.9			0	16.0			16.0
Barbados	17,380	0.0	44.3			0	14.8			14.8
Venezuela (Bolivarian Republic of)	10,278	0.0	36.8			0	12.3			12.3
Uruguay	16,230	0.0	34.4			0	11.5			11.5
Suriname	5,540	0.0	32.5			0	10.8			10.8
Panama	14,950	0.0	31.1			0	10.4			10.4
Bolivia (Plurinational State of)	3,530	0.0	55.0			0	18.3	8.4%	8.4	10.0
Chile	15,010	0.0	28.3			0	9.4			9.4
Guatemala	4,610	0.0	45.2			0	15.1	5.7%	5.7	9.4
Paraguay	5,510	0.0	55.5			0	18.5	11.0%	11.0	7.5
Peru	6,740	0.0	29.2			0	9.7	6.7%	6.7	3.0
Brazil	9,130	0.0	30.8			0	10.3	8.9%	8.9	1.3
Costa Rica	11,700	0.0	37.4			0	12.5	14.8%	14.8	-2.4
Colombia	6,510	0.0	31.7			0	10.6	16.5%	16.5	-5.9
El Salvador	4,000	0.0	41.2			0	13.7	22.1%	22.1	-8.3
Dominican Republic	8,090	0.0	52.4			0	17.5	26.1%	26.1	-8.7
Mexico	9,430	0.0	29.7			0	9.9	22.3%	22.3	-12.4
Argentina	11,200	0.0	24.3			0	8.1	21.4%	21.4	-13.3
Ecuador	6,080	0.0	32.5			0	10.8	26.1%	26.1	-15.2
Jamaica	5,250	0.0	58.1			0	19.4	41.0%	41.0	-21.6
Belize	4,450	0.0	43.1			0	14.4	41.2%	41.2	-26.8

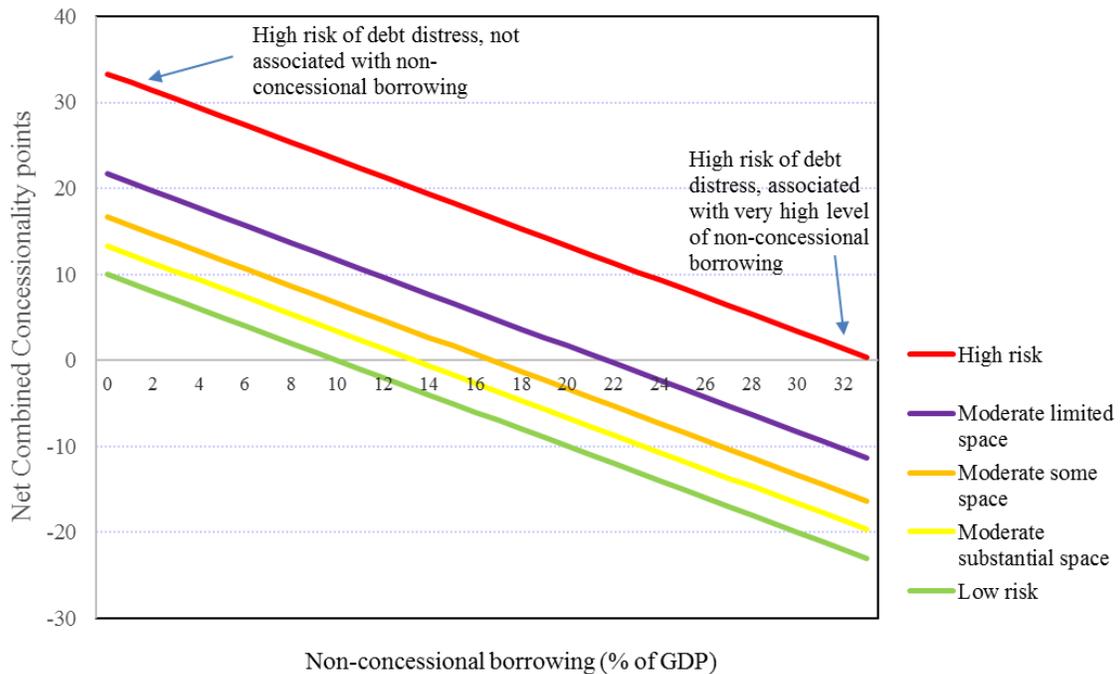
Notes: Data and calculations for countries not eligible for concessional resources have no operational relevance or implications. They are shown only to help illustrate scoring of concessional-eligible countries. In order to further help to illustrate and situate the scoring of IDB concessional-eligible countries, data for 142 countries is available at [Concessionality Score Spreadsheet2.xls](#). Blue shading indicates no IDS data for calculation of non-concessional borrowing. Hence, combined concessionality points for the country would be overstated.

ANNEX VI

CONTRIBUTION OF LOW PER CAPITA INCOME TO COMBINED CONCESSIONALITY POINTS



NET CONCESSIONALITY POINTS FROM DIFFERENT COMBINATIONS OF RISK OF DEBT DISTRESS AND NON-CONCESSIONAL BORROWING LEVELS



ANNEX VII

CONSIDERATIONS ON A VULNERABILITY INDEX

A number of principles or considerations were taken into account in constructing the proposed vulnerability index:

- The index should be broad enough to incorporate member countries' perspectives about sources of vulnerability, while remaining manageable, understandable, and transparent.
- There should be a reasonable technical basis for including a variable as part of the index of vulnerability.
- No variables should be included that contradict existing elements of the EPBA/DSF (for example the Country Institutional and Policy Evaluation).
- The index should be a composite index that draws on existing externally available indices in order to avoid generating significant new bureaucratic costs for the management of the concessional resources' framework.
- Such externally available indices must have data on all IDB concessional-eligible countries.
- The index should minimize moral hazard and "perverse incentives" by focusing on structural vulnerabilities and unavoidable exposures rather than vulnerabilities caused by policies.
- Measurement should be appropriate for the vulnerability variable: binary measurement for binary variables and continuous measurement scales for variables on a continuum.

In view of these considerations, Management has constructed a composite vulnerability index with the six components described below.⁴⁵ The **vulnerability index score** is the simple average of the scores on the six components.

Population size. An extensive literature on small states has analyzed the vulnerabilities and development challenges related to countries having a small population size (e.g. lack of economies of scale in the production of market goods and government services, lack of diversification).⁴⁶ Concessional assistance frameworks have responded to small population size through the criteria for eligibility to concessional resources (e.g. application of higher income per capita thresholds at the [IMF](#)) and through the level of concessionality provided ([IDA lending terms effective 10.1.2020](#)). The Population Index is the maximum-minimum [score](#) (scaled from 0 to 100) from the [United Nations \(UN\) least developed country category data](#). Countries with a population less than 150,000 have a score of 100 and countries with a population larger than 100 million have a score of 0.

Island/landlocked status and remoteness from principal markets. Some geographical features have been shown to represent an impediment to development. Islands and landlocked countries face increased transport costs, which has been a barrier to international integration and trade. Remoteness from international markets constitutes a similar barrier ([Gallup, Sachs and Mellinger 1998](#)). [IMF 2012](#) estimated

⁴⁵ The intended use of a vulnerability index dictates its design. The proposed composite vulnerability index has been designed solely for the purpose of helping to determine the appropriate blending of concessional resources in biennial concessional resource allocations.

⁴⁶ For example: Srinivasan, T. N. (1986) "The Costs and Benefits of Being a Small, Remote, Island, Landlocked, or Ministate", the World Bank Research Observer, Vol 1., No 2; [Commonwealth Secretariat/World Bank Joint Task Force on Small States \(2000\) "Small States: Meeting Challenges in the Global Economy."](#); Thacker, N., S. Acevedo and R. Perrelli (2012) "Caribbean Growth in an International Perspective: The Role of Tourism and Size", IMF WP/12/235.

that the island nature of small Caribbean states had reduced economic growth by 2.5 percentage points per annum on average. Scoring on the island/landlocked country status will be binary: a score of 100 for islands and landlocked countries; a score of 0 for other countries. The Remoteness Index is the maximum-minimum [score](#) (scaled from 0 to 100) from the [UN remoteness](#) index, where remoteness is defined as the trade-weighted average distance from the country's markets.

Exposure to natural hazards. Exposure to natural hazards is a key source of vulnerability for some borrowing member countries. The best option to measure exposure to natural hazards, in terms of the considerations above, is the Exposure sub-index of the World Risk Index (WRI) published annually in the [World Risk Report](#) by Bündnis Entwicklung Hilft. The exposure index of the WRI measures the proportion of countries' populations with physical exposure to a broad range of natural hazards: earthquakes, cyclones, floods, droughts and sea-level rise. Consequently, the exposure sub-index has a minimum of 0 and a maximum of 100.

Climate change vulnerability. Climate change will likely cause shifts in the frequency and intensity of extreme climate-related events and sea level rise. Maplecroft has produced a [Vulnerability Index to climate change in the Latin American and Caribbean Region](#) for the CAF. The Maplecroft Exposure Index evaluates the current risk of a region being impacted by extreme climate-related events (drought, wildfires, tropical cyclones and storms, storm surge, severe local storms, precipitation induced landslides, flooding and sea-level rise), as well as the risk posed by the projected changes in baseline climate parameters (air temperature, precipitation and specific humidity). Maplecroft presented the exposure index on a scale of 0-10, where values closer to 0 represent higher risk and values closer to 10 represent lower risk. For the proposed vulnerability index the values have been converted to a 0-100 scale where values closer to 100 represent higher risk. Climate change impacts are characterized by deep uncertainty. Vulnerability to climate change is dynamic, driven by context and local geography. Like climate change vulnerability, the indices used to measure it are context specific and no single index can be well-suited for all purposes. The Maplecroft Exposure Index has been selected as the most suitable for the purpose of contributing to determining concessionality levels for eligible countries.

Fragility. Two principal options for incorporating vulnerability related to conflict, and institutional and social fragility include: the World Bank's [harmonized list of fragile situations](#) and the [Fragile States Index](#) produced by the Fund for Peace. Both are updated annually. For the purposes of use in a vulnerability index, the harmonized list has two disadvantages. First, it is binary with no degree of graduation – states are categorized either as fragile or not fragile. Second, since one of the criteria for determining fragility is a harmonized CPIA score below 3.0, it is not a completely independent source. The Fragile States Index (FSI) is both completely external and the index of 178 countries better reflects the continuous, finely graduated nature of fragility. For the purposes of the vulnerability index, the FSI country rank was converted to a percentile rank (highest levels of fragility = highest percentile ranks).

ANNEX VIII
LAC CURRENT SCORING ON PROPOSED VULNERABILITY INDEX

Countries	Vulnerability index	Population		Island or landlocked (100 or 0)		Remoteness			Natural hazard exposure (World Risk Index 2020 - Exposure)		Climate change vulnerability		Fragile states index	
		Value	Max-min	Value	Score	Avg. distance	Adj. value	Max-min	Value	Score	Exposure score	0-100 score	Rank	Percentile rank
Argentina	24.3	43,847,430	12.7		0	9,485	80.7	88.4	9.55	9.55	7.32	26.8	138	8
Bahamas	55.4	391,232	85.3	SI	100	5,275	50.3	50.4	11.77	11.77	2.50	75.0	132	10
Barbados	44.3	284,996	90.1	SI	100	5,561	53.0	53.8	3.66	3.66	9.07	9.3	137	9
Belize	43.1	366,954	86.2		0	6,412	60.4	63.0	16.82	16.82	3.56	64.4	103	28
Bolivia (Plurinational State of)	55.0	10,887,882	34.1	L	100	8,214	88.3	97.8	9.56	9.56	6.00	40.0	70	49
Brazil	30.8	207,652,865	0.0		0	8,260	73.6	79.4	11.33	11.33	5.11	48.9	75	45
Chile	28.3	17,909,754	26.4		0	9,726	82.0	90.0	33.41	33.41	8.57	14.3	142	6
Colombia	31.7	48,653,419	11.1		0	6,726	62.9	66.1	14.65	14.65	5.41	45.9	65	53
Costa Rica	37.4	4,857,274	46.5		0	6,720	62.9	66.1	43.49	43.49	3.70	63.0	147	5
Dominican Republic	52.4	10,648,791	34.4	SI	100	5,455	52.0	52.5	24.85	24.85	2.28	77.2	107	25
Ecuador	32.5	16,385,068	27.8		0	7,280	67.0	71.3	17.96	17.96	5.82	41.8	89	36
El Salvador	41.2	6,344,722	42.4		0	6,701	62.7	65.9	31.69	31.69	2.68	73.2	93	34
Guatemala	45.2	16,582,469	27.6		0	6,702	62.7	65.9	36.52	36.52	1.66	83.4	58	58
Guyana	38.6	773,303	74.8		0	6,008	57.0	58.8	44.92	44.92	7.58	24.2	101	29
Haiti	63.0	10,847,334	34.2	SI	100	5,543	52.9	53.6	21.43	21.43	2.14	78.6	13	90
Honduras	41.3	9,112,867	36.8		0	6,564	61.6	64.5	20.25	20.25	2.73	72.7	64	53
Jamaica	58.1	2,881,355	54.5	SI	100	5,766	54.9	56.1	26.05	26.05	0.84	91.6	116	20
Mexico	29.7	127,540,423	0.0		0	6,849	63.8	67.3	14.09	14.09	3.35	66.5	98	30
Nicaragua	41.8	6,149,928	42.9		0	6,669	62.5	65.6	25.67	25.67	3.81	61.9	62	55
Panama	31.1	4,034,119	49.4		0	6,578	61.7	64.7	18.03	18.03	5.26	47.4	140	7
Paraguay	55.5	6,725,308	41.5	L	100	8,639	90.9	100.0	7.04	7.04	4.30	57.0	104	27
Peru	29.2	31,773,839	17.6		0	8,197	73.2	78.9	14.14	14.14	6.69	33.1	97	31
Suriname	32.5	558,368	79.8		0	6,014	57.1	58.9	15.41	15.41	7.99	20.1	115	21
Trinidad and Tobago	47.9	1,364,962	66.0	SI	100	5,792	55.1	56.4	23.39	23.39	7.02	29.8	129	12
Uruguay	34.4	3,444,006	51.8		0	9,455	80.6	88.2	36.29	36.29	7.27	27.3	157	3
Venezuela (Bolivarian Republic of)	36.8	31,568,179	17.7		0	5,950	56.5	58.2	16.12	16.12	5.07	49.3	28	79

Sources: VPC based on: (i) United Nations [DESA Least Developed Country Category data](#); (ii) [World Risk Report 2020 online](#); (iii) CAF/Maplecroft [Vulnerability Index to climate change in the Latin American and Caribbean Region](#); and (iv) the [Fund for Peace Fragile States Index](#).

Notes: Data and calculations for countries not eligible for concessional resources have no operational relevance or implications. They are shown for comparative information purposes only.

ANNEX IX

CALCULATION OF NON-CONCESSIONAL BORROWING SCORES

Data for the calculation of scores on the extent of non-concessional borrowing will be taken from the World Bank's International Debt Statistics (IDS) (e.g. [International Debt Statistics 2021](#)). This is an internationally respected source that has broad country coverage, consistent and comparable data treatment and which is updated annually and in a timely manner.

Non-concessional public and publicly guaranteed (PPG) external debt can come from two principal sources: private creditors (mainly international bonds and commercial credit) and bilateral creditors (particularly non-Paris Club bilateral creditors).⁴⁷

Data on **borrowing from private creditors** will use the IDS series "PPG, private creditors (DOD, current US\$)" [code: DT.DOD.PRVT.CD].

Data on **non-concessional borrowing from bilateral creditors** will be derived as a residual: **total borrowing from bilateral creditors** (IDS series "PPG, bilateral (DOD, current US\$)" [code: DT.DOD.BLAT.CD] **minus concessional borrowing from bilateral creditors** (IDS series "PPG, bilateral concessional (DOD, current US\$)" [code: DT.DOD.BLTC.CD]).

The focus of concern is non-concessional borrowing from bilateral creditors after the HIPC/MDRI debt relief processes. Consequently, as an adjustment, PPG external debt from bilateral creditors that existed prior to 2007 and for which HIPC debt relief is still pending will be subtracted from the amount of non-concessional borrowing from bilateral creditors. This adjustment will ensure that non-concessional borrowing scores will not be adversely affected by the failure of non-Paris Club bilateral creditors to provide [HIPC debt relief](#).

⁴⁷ Multilateral creditors typically provide concessional resources.