

'15 ANNUAL REPORT

Office of Evaluation and Oversight

**SUMMARY OF ACTIVITIES
and ANALYSIS OF
POLICY-BASED LENDING**



This report was prepared by a team led by Cheryl Gray (OVE Director) and Agustina Schijman (Economics Senior Specialist), with contributions from all OVE staff, consultants and research fellows. OVE greatly appreciates the helpful comments and suggestions received from internal peer reviewers, from IDB Management, and from members of IDB’s Board of Executive Directors.

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[Management Comments](#)

ACRONYMS AND ABBREVIATIONS

BRT	Bus Rapid Transport	MIF	Multilateral Investment Fund
CCT	Conditional Cash Transfer	OVE	Office of Evaluation and Oversight
CPE	Country Program Evaluation	PBL	Policy-based loan
DDO	Deferred-Drawdown Option	PBP	Programmatic Policy-based loan
DEF	Development Effectiveness Framework	PCR	Project Completion Report
DEM	Development Effectiveness Matrix	PMR	Project Monitoring Report
IDB	Inter-American Development Bank	PPP	Public-Private Partnership
IIC	Inter-American Investment Corporation	ReTS	Evaluation Recommendation Tracking System
IMF	International Monetary Fund	SFD	Sector Framework Document
LAC	Latin America and the Caribbean	SG	Sovereign-guaranteed
MDB	Multilateral Development Bank	TC	Technical Cooperation
M&E	Monitoring and Evaluation	WB	World Bank
		XSR	Expanded Supervision Report



The Inter-American Development Bank (IDB) is a key multilateral development bank serving Latin America and the Caribbean (LAC). It provides lending, technical cooperation, partnerships, and knowledge sharing to help the LAC region achieve strong and sustainable economic growth and social development. The Office of Evaluation and Oversight (OVE) is an independent office in IDB reporting directly to the Board of Executive Directors. Its role is to evaluate the projects, programs, and policies of IDB with the aim of learning from experience and enhancing the Bank's development effectiveness. All of OVE's evaluations and management responses are disclosed to the public and are available at www.iadb.org/evaluation.

This is the second Annual Report OVE has produced. As in last year's report, the first part provides a brief overview of the evaluation work OVE undertook in 2015. The second part addresses a special topic of current relevance in IDB—this year, policy-based lending. Policy-based loans are a key component of IDB's toolkit to assist LAC countries. IDB Management intends to review its lending instruments in 2016, and OVE's analysis of the Bank's design and use of policy-based loans (with further detail in the accompanying technical note) provides inputs to that review.

Cheryl W. Gray
Director

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REPORT

PART 01

EVALUATION ACTIVITIES IN 2015

PART 01

EVALUATION ACTIVITIES IN 2015

Each year the Office of Evaluation and Oversight (OVE) undertakes 12-18 major evaluations, grouped into four broad categories: project evaluations, sector and thematic evaluations, country program evaluations, and corporate evaluations. This product mix is intended to serve multiple stakeholders – the Board and Governors of IDB, Bank management and staff, and officials in the Bank’s client countries. Table I.1 shows the major evaluations undertaken by OVE in 2015.

PROJECT EVALUATIONS

Project evaluations underpin all other evaluation work – whether at the country, sector, thematic, or corporate level. An accurate picture of IDB’s results requires a clear understanding of the performance – including the relevance, effectiveness, efficiency, and sustainability – of the projects it supports.

TABLE I.1: OVE 2015 Evaluations**Project Evaluations**[Bus Rapid Transit \(Colombia, Peru, Uruguay\)](#)[Procidades \(Brazil\)](#)[Conditional Cash Transfer Programs in Low-middle Income Countries \(El Salvador, Honduras, Guatemala\)](#)

Green Lending*

Sector and Thematic Evaluations[Agriculture and Food Security](#)

IDB Lending through Financial Intermediaries*

Country Program Evaluations[Bolivia](#)[Brazil](#)[Colombia](#)[Panama](#)[Uruguay](#)**Corporate Evaluations**

OVE Annual Report: Policy-Based Lending*

[Measuring Project Performance](#)

IIC Project Validations

[Review of the Recommendation Tracking System](#)**for final delivery in early 2016*

OVE completed several in-depth comparative project reviews in 2015. The first was an evaluation of [bus rapid transport \(BRT\)](#) projects in three cities: Lima (Peru), Cali (Colombia), and Montevideo (Uruguay). BRT systems have become an increasingly popular approach to addressing mobility and environmental problems in urban areas in Latin America and around the world, and IDB's support for these systems has grown

rapidly in recent years. Of the three projects reviewed, Lima's system stood out from a transport engineering point of view, producing the highest travel-time savings and corridor-level emissions reductions. Cali's system also provided substantial travel-time savings for trips along the trunk lines and had a much wider impact on emissions reductions in the city as a whole because of its ambitious scale and more successful bus-scraping program. In addition, important improvements to public spaces were part of both the Cali and Lima projects. In Montevideo, because of poor design and corridor choice and a lack of bus sector reforms, the system realized few mobility or environmental objectives; however, passengers benefited from improved sidewalks, a new electronic fare card system, integrated tariffs, and a GPS system enabling real-time information on bus arrivals and advice on the best route combination from any origin to any destination in the city. The design and implementation of complementary measures – such as public-private contracting, pedestrian planning, and bus scrapping programs – faced weaknesses of varying degrees in all three cases and could have benefited from increased Bank support during design and implementation.

A second comparative project evaluation completed in 2015 looked at Brazil's experience with [Procidades](#), an umbrella facility supporting a large number of Brazilian sub-national governments. The Procidades facility was approved in 2006 with a strategic approach to reach a larger pool of medium-sized municipalities in Brazil. In designing the program, the Bank correctly identified the main challenges to implementing it – lack of institutional capacity and high transaction costs at the municipal level. The Bank responded with a number of strategies to address these challenges: delegating approval, hiring technical support providers, outsourcing project supervision, developing software for project management, and focusing heavily on institutional strengthening. However, virtually none of these strategies worked as planned, and average preparation and supervision costs for the projects in the facility have been substantially above Bank averages. Despite these implementation challenges, Procidades has allowed IDB to provide direct support to Brazilian municipalities, and the approved operations have made some progress toward their general objective of improving the quality of life of the municipal populations.

In a third comparative project evaluation, OVE reviewed Bank support for [conditional cash transfer programs \(CCTs\)](#) in El Salvador, Guatemala, and Honduras. The evaluation focused on the institutional underpinnings needed for a successful CCT program in lower-middle-income countries and on the issues of institutional development these three countries faced. The evaluation found mixed results summarized in Box I.1.

BOX I.1**COMPARATIVE REVIEW OF IDB INSTITUTIONAL SUPPORT TO CONDITIONAL CASH TRANSFER PROGRAMS IN THREE LOWER-MIDDLE-INCOME COUNTRIES**

Conditional cash transfer (CCT) programs are among the principal measures used to tackle poverty in developing countries. The IDB has actively supported the expansion of CCT programs in LAC since the late 1990s. The experience accumulated during these decades has included both successes and failures, and has provided important lessons for the design of new operations.

OVE's evaluation analyzed the effectiveness of IDB support for developing and implementing CCT programs in three lower-middle-income countries: *Red Solidaria-Comunidades Solidarias* in El Salvador; *Mi Familia Progresá-Mi Bono Seguro* in Guatemala; and *Programa de Asignación Familiar* II and III, and *Bono 10.000* in Honduras. This evaluation used a "component-based" methodology that determines the effectiveness of a program or policy by comparing the characteristics of its specific components against a selected standard. For the CCT programs, 10 standard components were identified.

Although IDB's total financial support has been similar for each country, the timeline and mix of support instruments for each CCT program have been unique. Since 2000 the Bank has supported three different CCT programs in Honduras through 4 policy-based loans (PBLs), 11 investment loans, and 19 technical operation operations (TCs) with a cumulative value of US\$538.9 million. In El Salvador, since

2004 the Bank has supported 2 CCT programs through 3 PBLs and 8 TCs totaling US\$502.5 million. In Guatemala, since 2009 the Bank has supported two CCT programs through 2 PBLs and 3 TCs totaling US\$550 million.

Evidence from this evaluation indicates that in the 3 countries, IDB technical support, particularly through investment lending, was positively associated with more effective CCT components, specifically in the areas of poverty measurement, the design of targeting and registry systems, and external evaluations. In each case, clients identified Bank staff's experience and knowledge as a comparative advantage. However, IDB support has had limited results in institutional components whose activities are more directly tied to the state's capacity to implement programs, including the monitoring of conditions, payment administration, and support of complementary services. Moreover, the 3 countries face fiscal restrictions that affect the institutional functioning of the CCT programs. Even with IDB support, programs have not been able to make payments to beneficiaries on time.

THE EVALUATION PROVIDED FOUR SUGGESTIONS, GENERALLY SUPPORTED IN IDB'S MANAGEMENT RESPONSE:

Ensure that there is a comprehensive diagnosis of institutional needs that will help identify and prioritize CCT components that require immediate support.

Strengthen Bank support to institutional components requiring ongoing government capacity and coordination, such as the monitoring and enforcement of conditions and administration of payments.

Analyze the funding needs of CCT programs (as part of broader social protection spending) and take this information into account when deciding on lending instruments and the amount of support.

Systematize knowledge and lessons learned from previous operations, processes, and evaluations.

Finally, OVE is now completing a comparative evaluation of three “green lending” projects in Chile, Colombia, and Costa Rica. This evaluation, which complements OVE’s broader review of lending through financial intermediaries (see below), takes an in-depth look at the rationale, design, implementation, and results of these efforts to increase lending for environment-related investments in LAC.

SECTOR AND THEMATIC EVALUATIONS

Sector and thematic evaluations provide in-depth analysis of IDB’s engagement and lessons of experience in a substantive area as well as advice on future strategic directions. In 2015 OVE delivered a sector evaluation on [agriculture and food security](#) (Box I.2). This evaluation analyzed 10 years of Bank lending in the agriculture sector and undertook in-depth comparative work in three areas of particular focus in the Bank’s portfolio: direct support to farmers, animal and plant health, and land titling.

OVE also neared completion of a broad evaluation of the Bank’s support through financial intermediaries from 2005 to 2014, for the first time fully incorporating the IIC

BOX I.2

IDB'S SUPPORT TO AGRICULTURE, 2002-2014: EVIDENCE FROM KEY THEMATIC AREAS

Between 2002 and 2014, 83 agriculture loans worth US\$3.9 billion (about 3% of the Bank's portfolio) were approved, and 167 operations in other sectors also provided some support to agriculture. The Bank's agriculture portfolio has focused primarily on increasing the sector's growth, and secondarily on improving the income of small producers. A large part of the portfolio has provided direct support to producers and to agricultural services, while projects in other Bank sectors have focused on infrastructure. Despite the fact that Bank support has tended to concentrate in poorer countries or those with larger agriculture sectors relative to GDP, the portfolio is not highly poverty-targeted, and the current automatic classification of all agricultural projects as poverty-oriented is inaccurate.

The portfolio has generally been relevant and aligned with the Bank's strategic documents. The projects OVE reviewed in three key thematic areas have achieved mixed results. Many of the projects providing *direct support to producers* have been at least partially relevant and effective, though their long-run sustainability is questionable. Moreover, the direct support to farmers, mostly through private goods, seems inconsistent with the emphasis of the 2013 Sector Framework Document (SFD) on Agriculture and Natural Resources Management on public goods. Some projects supporting agricultural health and food safety have had positive results, but LAC's main challenge is access to food rather than availability of food, calling for a broader multi-sector approach than was taken in the Bank's Ninth General Capital Increase (which focused on agricultur-

al productivity). In addition, the fiscal sustainability of some services provided by the agencies has been a challenge. Projects supporting *land regularization and administration* have been comprehensive, addressing the foundations and functions of the land administration systems and embarking on mass regularization. Sustainability is a concern in many projects because the root causes of the challenges facing the sector have not been addressed, and results in all three thematic areas could be enhanced with deeper diagnosis of problems and their root causes. While projects have increasingly included impact evaluations, continued efforts to strengthen project M&E are warranted.

THE EVALUATION MADE FIVE RECOMMENDATIONS, GENERALLY SUPPORTED IN IDB'S MANAGEMENT RESPONSE:

Delineate clear criteria in the 2016 update of the SFD to guide any Bank financing of private goods.

Promote a comprehensive and coordinated multisectoral approach to food security through the upcoming SFD on Food Security.

Adjust the Bank's project classification system to more accurately reflect the contributions of the agriculture portfolio to poverty reduction.

Ensure adequate upstream diagnostic work to fine-tune project identification and design. Alternatively, begin with a pilot project that acts as a diagnosis phase.

Continue to enhance monitoring and evaluation to promote learning and long-term effectiveness.

and the MIF in an IDB Group-wide evaluation of an issue. This evaluation covers operations totaling \$17 billion, accounting for about 14 percent of total IDB Group approvals during the period. It analyzes what operations were supported and with what objectives; how the various IDB Group windows selected, structured, and implemented these operations; and to what extent the objectives were achieved. This evaluation is expected to be discussed at IDB's Board of Executive Directors and disclosed to the public in March 2016.

COUNTRY PROGRAM EVALUATIONS

Country Program Evaluations (CPEs) analyze the relevance and effectiveness of IDB's support to an individual borrowing country over four to five years. This usually corresponds to the time covered by the most recent Country Strategy, and the CPE analyzes that strategy along with the relevance, implementation, and effectiveness of the Bank program (including the entire range of public and private sector lending and technical cooperation). OVE completed five CPEs in 2015: for Bolivia, Brazil, Colombia, Panama, and Uruguay.

The [CPE for Bolivia](#) covered a period of profound transformation in the country, as the new constitution of 2009 redefined the role of the public sector in the economy and decentralized important responsibilities to subnational governments. The size of the operational program tripled during the 2011-2015 period covered by the evaluation, and there were improvements in program management by the country office. Going forward, Bolivia's economic context is changing, with lower growth and fiscal tightening, while the government's ambitious plans to expand the coverage of basic services are facing challenges of quality and sustainability. The CPE recommended that the Bank continue to work with the country to consolidate recent reforms, build the capacity of subnational governments, increase the focus on sustainability of investments, and look for opportunities to partner with the private sector.

The [CPE for Brazil](#) covered the Bank's biggest country program, with over US\$10 billion in lending during 2011-2014. Brazil experienced solid economic growth and declining poverty during the decade up to 2014, though recently there has been a marked deterioration in the economic and political environment. Over the medium term, the country continues to face significant deficits in infrastructure and public services that limit its productivity and competitiveness. The evaluation's findings are summarized in Box I.3.

The [CPE for Colombia](#) found that the Bank's program was broad, diverse, and relevant. About two-thirds of the lending was policy-based, and it was accompanied by large amounts of TC. These programs supported important reforms in health, decentralization, and transport, though four of the six PBP series were truncated. On the investment lending side, important results were obtained in transport, decentralization, and social protection. Going forward, the CPE recommended that the Bank strengthen the design, monitoring, and completion of policy-based programs, strengthen risk analysis to reduce the costs of dropped or cancelled projects, seek new ways to work with subnational governments, test the usefulness of "fee for service" technical cooperation, and expand its support in rural areas.

The [CPE for Panama](#) covered a period of rapid economic growth in the country, averaging 8.6% since 2010. The CPE found that the Bank's program from 2010-14 was flexible, diverging considerably from what was anticipated in the Country Strategy. Approved loans and grants during the period totaled about US\$2 billion, far above the amount envisioned in the strategy. About 72% of sovereign-guaranteed (SG) lending during the period was policy-based. Three of the four policy-based series were truncated, with the thematic focus shifted from fiscal reform to disaster risk management to financial sec-

BOX I.3**COUNTRY PROGRAM EVALUATION:
BRAZIL 2011-2014**

The Bank continued to be an important source of international financing to Brazil during the 2011-2014 evaluation period. The Bank approved 175 operations (loans, guarantees, and grants) totaling US\$10.45 billion. While the proportion of federal and municipal lending remained approximately the same as in the previous period, lending to the states increased and lending to the Brazilian Development Bank stopped. Lending to the private sector fell and shifted from real sector operations to the financial sector; the Bank found a market niche in trade finance, where there was high demand for its hard currency and longer-tenor loans.

The Bank's program focused on relevant development challenges, including infrastructure, the social sectors, and fiscal/institutional issues. It was able to engage states and municipa-

lities in the health, education, and citizen security sectors through substantial investment in TC and dialogue. As the Country Strategy envisioned, the program increased its focus on the poorest regions of the country and made some efforts to include gender and diversity as a cross-cutting issue.

The efficiency of project cycle remains a concern, as preparation and implementation costs in Brazil tend to be higher and preparation times slower than the Bank's average—at least partly because the Bank has shifted its lending from the federal government to subnational governments, which is more costly (albeit arguably also more needed). Results of the program appear to have been mixed, with some significant successes in most sectors.

**OVE MADE SIX RECOMMENDATIONS, GENERALLY SUPPORTED IN
MANAGEMENT'S RESPONSE:**

Work with the client to define a limited set of strategic thematic priorities to structure and integrate the Bank's program.

Seek long-term partnerships with subnational governments where possible, and devote substantial resources to cross-learning.

Continue to work with states and municipalities on deepening public finance reform.

Seek ways to work with the Brazilian authorities to help strengthen regulatory frameworks for public-private partnerships at various levels of government.

Develop a concrete plan to promote more effective cross-sector and public-private collaboration in the country program.

Continue to strengthen the monitoring and evaluation of the Bank's portfolio.

tor regulation. The investment lending portfolio was fairly small but well-targeted, and it offered an opportunity to concentrate financial and technical resources outside of the Panama City-Colon Corridor. Going forward, OVE recommended that the Bank structure the new Country Strategy around key cross-cutting themes rather than sectors, redouble support for Panama's pro-poor development agenda, continue to include strong institution-building components, and strengthen risk analysis and project design to reduce project cancellations.

Finally, the [CPE for Uruguay](#) highlighted the close partnership that IDB has had with the country, including serving as its largest multilateral provider of finance. Uruguay has also been the main user of the Bank's contingent financing instrument, the Deferred-Drawdown PBL, or DDO. The Bank's 2010-2015 program achieved important advances, especially in energy (including renewable energy through the private sector), innovation, trade facilitation, and housing. Going forward, the CPE recommended that the Bank enhance the multisector focus of the country strategy, find an appropriate balance between contingent and investment lending, deepen the analysis of infrastructure project costs to avoid overruns, design a knowledge strategy with the country, and explore new lending instruments and multiyear programming to meet the emerging needs of Uruguay and other upper-middle-income clients¹.

CORPORATE EVALUATIONS

Corporate evaluations focus on the IDB's own structure and processes and examine how they affect the development effectiveness of the IDB's work. The major corporate product undertaken by OVE in 2015 is the extensive review of [IDB's policy-based lending](#) documented in a separate technical note and summarized in Part II of this Annual Report.

¹ Management Responses for all CPEs and other evaluations are available at www.iadb.org/evaluation. Management agreed with most of OVE's recommendations in the CPEs completed in 2015, though the Management Responses contain important nuances and qualifications. In the case of the Uruguay CPE, the Board endorsed OVE's five recommendations but requested that the last two be further discussed by relevant Board committees, given their institutional nature.

BOX I.4**MEASURING PROJECT PERFORMANCE AT THE IDB**

In 2015 OVE continued to work with IDB Management to develop a strong evaluation system, in line with the requirements for the Development Effectiveness Framework (DEF) mandated in IDB's Ninth General Capital Increase. Downstream results measurement is the final phase in the DEF, complementing the Development Effectiveness Matrix (DEM) at project approval and the Project Monitoring Report (PMR) during project implementation. The development of all aspects of the DEF – and particularly this final downstream phase – is a positive story of progress over the past several years for both public and private sector projects in the IDB Group.

On the public sector side, in August 2014 the Bank adopted new guidelines for Project Completion Reports (PCRs), after a long period of development and an early 2014 pilot exercise testing the framework on 12 closed projects. This evaluation reviewed the guidelines and the pilot PCRs and found that PCR quality has improved markedly under the new approach. Going forward, the evaluation recommended a few adjustments to the guidelines—in the ratings methodology, the format of the PCR reporting tool, and the treatment of environmental and social safeguards—to help fine-tune them and align them with the evolving approach in the private sector.

On the private sector side, OVE has worked with the private sector windows of the IDB Group over the past year to develop new guidelines for project-level results measurement and reporting. The new approach (called XSR, or Expanded Supervision Report) focuses more centrally on development effectiveness than past approaches have. The new guidelines for public and private sector projects are very similar (particularly with the fine-tuning suggested in the evaluation), thus facilitating greater comparability in results metrics for projects across the IDB Group.

Now that a strong and unified framework for results reporting is being put in place across the IDB Group, the main challenge will be ensuring efficient and effective implementation. If well implemented, the new systems can promote learning and improve overall IDB results. It is important that project teams and counterparts have the resources and incentives to design evaluable projects, monitor them effectively, and report results accurately based on evidence. Management, the Board, and OVE will all have a role in helping these efforts succeed.

IDB has made significant strides in improving the architecture for project evaluation in recent years, and OVE has worked closely with IDB Management in this effort. In 2015 OVE completed a [review of IDB's systems for measuring project performance](#) (see Box I.4). The review examined recent efforts to unify project performance measurement for both public and private sector lending and across the various private sector windows in the IDB Group. It also reported project results for the most recent set of project self-evaluations validated by OVE. A second report on project results in IIC was discussed at the IIC Board in October 2015.

In 2015 OVE and SPD also hired an independent consultant to review the pilot phase of the [Recommendation Tracking System](#) (ReTS), an online system to track progress with Management's implementation of Board-endorsed recommendations in OVE evaluations. The report, presented to the Board in September 2015, will serve as the basis for updating the ReTS Protocol to improve efficiency and effectiveness. Given that 2015 was a transition year, the Board agreed that OVE should not report on actions taken by management to address recommendations in this Annual Report.

OUTREACH AND EVALUATION CAPACITY DEVELOPMENT

To foster learning and knowledge sharing, OVE dedicates substantial effort to outreach, both within IDB and with partners and country counterparts in the LAC region. OVE seeks to make its evaluations easily accessible through its publications and website, focused dissemination events, and participation in workshops and conferences. Among the major events OVE supported in 2015 were a LAC-wide climate change workshop in Mexico City (including presentation of OVE's 2014 climate change evaluation), a workshop bringing together LAC experts on animal and plant health in Managua, Nicaragua (including presentation of OVE's 2015 agriculture evaluation), and a panel at a major Brazil conference around OVE's 2014 evaluation of programs supporting small and medium-sized enterprises.

Finally, OVE's mandate also includes developing evaluation capacity in LAC countries. OVE has leveraged its modest resources by continuing to participate actively in the CLEAR Initiative. CLEAR ("Centers for Learning on Evaluation and Results") is a joint program of 10 multilateral and bilateral donors and foundations to support M&E ca-

capacity-building centers in four world regions (<http://www.theclearinitiative.org/>). The [Centro de Investigación y Docencia Económicas in Mexico](#) was selected in 2012 as the Spanish-speaking LAC center, and in September 2015 a Portuguese-speaking center was launched at the [Getulio Vargas Foundation](#) in São Paulo. These two Centers have outstanding expertise and dedication to evaluation, and OVE looks forward to fruitful collaboration.

Going forward, OVE's work program for 2016 (Table I.2) includes a broad array of evaluations. With the merge-out of all private sector windows into the Inter-American Investment Corporation (IIC), OVE will assume responsibility as the independent evaluation office for IIC. Thus, all CPEs and other relevant evaluations will cover both IDB and IIC, and several evaluations – including public-private partnerships (PPPs) in infrastructure, equity investing, and the implementation of the merge-out – will deal with issues that are central to IIC's mandate. The OVE program also includes further work on IDB instruments and operational efficiency, an evaluation of the special IDB program on sustainable cities, several major CPEs (including reviews of the large IDB programs in Argentina and Haiti), and impact evaluations and project-level reviews in the areas of private sector productivity, housing, rural water, and urban transport and poverty.

TABLE I.2 OVE 2016 Evaluations**Project Evaluations**

PCR and XSR Validations

Rural Water (Paraguay)

Support to Productive Sectors (Brazil)

Urban Transport and Poverty

Sector and Thematic Evaluations

Infrastructure PPPs

Sustainable Cities

Country Program Evaluations

Argentina

Guatemala

Haiti

Peru

Suriname

Trinidad and Tobago

Corporate Evaluations

Annual Report: Implementation of the Private Sector Merge-Out

Equity Investing

Contingent Lending Instruments

IDB Operational Efficiency

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PART 02

**POLICY-
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PART 02

POLICY- BASED LENDING IN IDB

The second part of the Annual Report explores a relevant theme in greater depth. Last year Part II of the Annual Report explored the implications of OVE's evaluation findings for the IDB's broader objectives of sustainable growth and poverty reduction. This year Part II explores the design and use of an important IDB lending instrument, PBLs. OVE has never before taken an in-depth look at the design and use of this instrument across IDB borrowers, though its CPEs and sector and thematic evaluations have reviewed the use and effectiveness of PBLs in particular countries. Given that IDB Management is planning a comprehensive review of IDB's lending instruments in 2016, this is an opportune moment for OVE to review how the instrument is used in practice and how it has evolved over time. More detailed analysis is available in the technical note accompanying this report (see Annex).

ORIGINS AND EVOLUTION OF PBLs IN IDB

Like most multilateral development banks (MDBs), the IDB was created with the expectation that it would mostly finance investment projects. In fact, the 1959 *Agreement Establishing the IDB* states that “loans made or guaranteed by the Bank shall be principally for financing specific expenditures.” Investment operations can incorporate some policy and institutional strengthening components to help overcome constraints that hinder investment effectiveness, but they rarely envisage significant structural changes.

In 1989, following the debt crisis in LAC, the IDB introduced policy-based lending, then called “sector lending,” under the Seventh Replenishment (IDB-7). Adapting the model of structural adjustment lending created by the World Bank (WB) in the late 1970s, the Bank established this new instrument for two purposes: to provide borrowing countries with liquidity to help meet their financing needs and to support them in undertaking reforms. The main characteristic of policy-based lending that differentiates it from investment lending is that proceeds are disbursed on the basis of compliance with agreed-upon conditionality (policy and institutional reforms), rather than against specific expenditures.

To ensure that investment projects remained the Bank's core development assistance tool, since 1989 the Bank has established aggregate limits on policy-based lending. Since 2011, the cap has been set at 30% of total Bank lending on a four-year cycle, and approvals have remained below the cap.

As the Bank's borrowing member countries experienced higher growth, strengthened their institutional capacity, and gained better access to capital markets, new PBL modalities were added to the original multi-tranche instrument. Two modalities have added significant flexibility: the programmatic variant of PBLs (PBPs), introduced in 2005 (under which a sequence of loans supports a given reform program), and the deferred draw-down option (DDO) modality, added in 2012 (under which proceeds can be disbursed if and when they are needed). Moreover, the Bank has expanded its own analysis on the adequacy of countries' macroeconomic frameworks and progressively moved to reduce its dependence on International Monetary Fund (IMF) views.

The use of policy-based lending for development has been subject to many debates over the years. Some common questions, summarized in Box II.1, relate to the fungibility of

BOX II.1 .

MAIN ISSUES RELATED TO THE INTRODUCTION OF POLICY-BASED LOANS

How fungible is development money? The MDBs were created under the premise that they would mostly finance specific expenditures related to investment projects. PBLs, which provide budget support, were originally perceived to be at odds with this premise. However, there are two main reasons why the difference between instruments might be inflated. Let's think of a US\$1 billion investment loan that finances roads. Because loan resources free up cash that can be used for other purposes, the loan is unlikely to increase total spending on roads by US\$1 billion. In this regard, estimates have suggested that the net effect of a dollar of foreign assistance (including MDB lending) is to increase public investment by only 29 cents—exactly the amount by which any additional dollar of government resources would have raised investment.^a This means that (i) total investment does not increase by the full amount of the investment loan; and (ii) the expenditure that the Bank thinks it is financing is not really the marginal investment financed by the loan.

Are the twin goals of PBLs compatible?

The introduction of policy-based lending raised questions on the appropriateness of pursuing two distinct objectives with one instrument. This controversy was well illustrated in the IDB in the mid-1990s, when Management stated that “the balance of payments motiva-

tion for policy based lending often creates an environment in which the policy elements of loans become secondary to the primacy of balance of payments concerns” (GN-1955). To reinforce this point, Management quoted a paper by Professor G. Ranis: “One of the inherent difficulties [...] is that it is impossible to achieve two objectives with one instrument. If, in the wake of the Brady Plan, the MDBs are asked to pump out the money on behalf of debt relief we should not expect the obiter dicta concerning policy change to be taken very seriously by either party” (FN-1955, para. 5.11).

Should PBLs leverage reforms, support reform implementation, or reward past behavior?

As originally conceived, conditionality in PBLs was aimed at incentivizing reforms: conditions were generally measures that the borrowing country needed to undertake for the resources to be disbursed (that is, they rarely included measures that had already been undertaken). In the 1990s, scrutiny over conditionality increased—precisely related to the idea that money can “buy” hard policy reforms, even in the absence of country ownership. In addition to ownership issues, this approach had credibility issues: “If the basic motivation of donors for going into policy conditionality is to disburse big money fast, then the credibility of an enforcement agency is destroyed.”^b The original approach has changed over time,

a World Bank, 1998, *Assessing Aid: What Works, What Doesn't, and Why*. Cambridge: Oxford University Press.

b P. Collier in World Bank, 2005, *Conditionality Revisited. Concepts, Experiences, and Lessons*. Washington, DC: World Bank.

and PBLs (including the IDB's) have increasingly included measures already undertaken by borrowing countries (even before the loans were included in the pipeline). In this regard, it is usually recognized that in programmatic series, first loans tend to reward past achievements, while subsequent operations try to incentivize new actions. Which is the most appropriate approach or the right balance is still an open question. For instance, some believe that piggybacking on past actions is preferable in countries with strong institutional settings, but that MDBs should try to incentivize new reforms when track records are weak and credibility issues arise.^c

How effective is conditionality? There was (and continues to be) inconclusive empirical evidence on the effect of MDB lending and conditionality on poverty reduction, on the likelihood of bad governments surviving, and even on the likelihood of policy reform. The main lesson learned from the literature was that conditionality can be useful in helping to identify and implement reforms but can only succeed when there is country ownership. In 2005, that lesson underlay the OECD High Level Forum on Aid Effectiveness and the resulting Paris Declaration.

Should policy-based lending be conditioned on good governance and country systems? Since funds provided as budget support are subject to countries' own public financial management systems, effective use of these resources hinges on the reliability of such systems, and more generally on the quality of governance and institutions in the country. A subject of repeated debate has therefore been whether PBLs should be confined to borrowing countries with sufficiently good public financial management systems and strong governance institutions—recognizing, however, that what precisely constitutes “sufficiently” is likely to be somewhat arbitrary.

c Ibid.

different forms of development finance, the compatibility of financial and policy reform goals in policy-based lending, the extent to which causation (or “additionality”) needs to be evident in donor funding, the role of conditionality, and whether or not the extent of policy-based lending should be linked to the reliability of a country’s underlying governance and financial management systems.

While the Bank’s evolving PBL framework has clearly accommodated the twofold motivation for policy-based lending (financing and reform), it has provided little clarity on which of its two broad purposes should dominate. At times, that lack of clarity has translated into weak design features and guidelines. For instance, the Bank’s PBL operational guidelines do not provide specific guidance on what qualifies as a policy or institutional reform, and thus as appropriate policy conditionality. Moreover, the definition of the specific lending ceilings for PBLs has lacked analytical and empirical grounding.

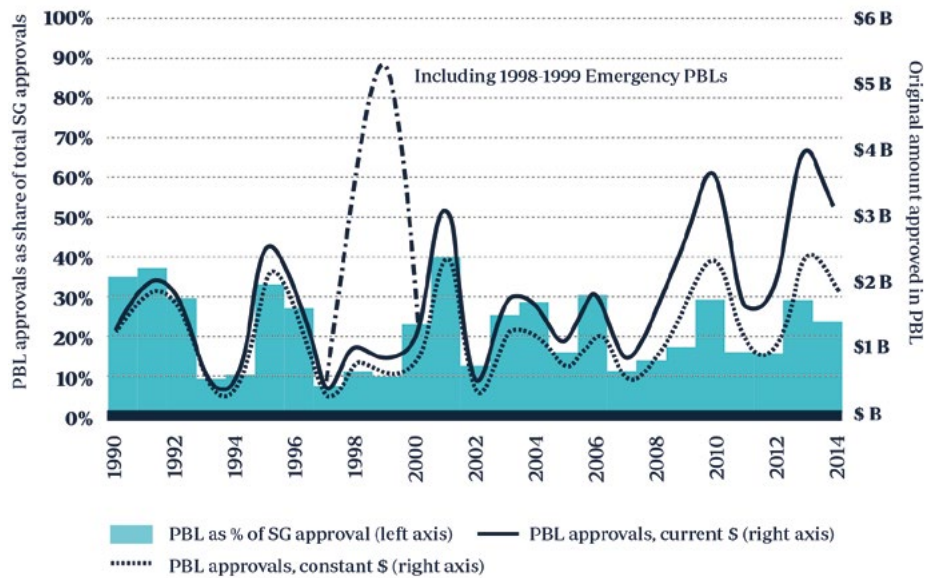
PORTFOLIO TRENDS

Since establishing policy-based lending in 1989, the Bank has approved about 300 PBLs, contained in 230 policy-based programs (as a program may be supported by more than one loan). In the instrument’s 25 years of existence, policy-based lending has totaled US\$45 billion, accounting for one-quarter of the Bank’s total SG lending and 28% of SG disbursements. The IDB is the second-largest provider of policy-based financing to LAC, after the WB.

Reflecting the expansion of overall Bank lending, policy-based lending has increased over time (at constant prices). It has also intensified in times of economic turmoil: for instance, during the Tequila crisis in 1995, PBLs represented around 30% of total Bank lending, up from 10% in 1994; similarly, demand for regular PBLs increased sharply during the 2001 crisis in Argentina and other Southern Cone countries, and during the international financial crisis in 2008-2009 (Figure II.1). However, OVE found that PBLs have played a modest countercyclical role in practice,² though some fast-disbursing investment lending is likely to have supplemented that role during the 2008 financial crisis.

² Several factors limit PBLs’ capacity to provide effective countercyclical support. First, PBLs cannot be approved or disbursed if borrowers do not have a positive macroeconomic assessment. Second, the total amount of policy-based lending is subject to the 30% aggregate cap. Third, the impact of IDB’s lending in middle-sized and large countries is necessarily limited by its small size in relation to their economies.

FIGURE II.1. PBL Total Approved Amount, 1990-2014



Source: OVE based on IDB data warehouse. Unless otherwise indicated, excludes emergency lending
 Note: Constant values are based on GDP Implicit Price Deflator in the United States, 1900=100

All LAC countries have received at least one PBL, though PBL use has differed greatly across countries in the region. There is no statistically significant relationship between the use of PBLs and either GDP per capita or the level of a country's institutional development (as measured by commonly used indicators). During the last decade, PBLs accounted for the large majority of SG approvals in several countries (including Colombia, Guatemala, Peru, Jamaica, and Suriname) while being practically (or totally) non-existent in others. In terms of absolute approval amounts, Brazil, Mexico, and Colombia have been the three top PBL recipients over the past decade, accounting for about half of total PBL approvals. Nevertheless, the Bank's policy-based lending has been less concentrated than that of the WB. WB policy-based lending is more concentrated in large and upper-middle-income countries than IDB's, with fewer countries receiving PBLs overall (Table II.1).

TABLE II.1. Relative Usage of PBLs (IDB) and DPLs (World Bank), 2010-2014

		IDB		
		Above-median PBL user (as % of SG lending)	Below-median PBL user (as % of SG lending)	Non-user
WB	Above-median DPL user (as % of SG lending)	Colombia Dominican Republic Guatemala Jamaica Panama	Brazil Mexico Uruguay	
	Below-median DPL user (as % of SG lending)	Peru	El Salvador Haiti Honduras Paraguay	
	Non-user	Barbados Suriname	Bolivia Chile (cancelled) Guyana Nicaragua The Bahamas Trinidad and Tobago	Argentina Belize Costa Rica Ecuador Venezuela

Note: Barbados, Trinidad and Tobago, and The Bahamas were not eligible for WB loans during the period due to per capita income limitations. IDB does not have similar "graduation" rules for borrowers.

In terms of complementarity with other Bank instruments, a great majority of PBP series have been accompanied by parallel TCs, which usually have supported policy dialogue, diagnostic work, and compliance with conditionality (Figure II.2). The support provided by TCs is especially relevant for two reasons. First, while resources from a PBL go to the country's treasury, parallel TCs provide direct support for the line ministries in charge of the reforms. Second, there is a strong positive link between TC support and the likelihood of completing a PBP series. On a smaller scale, investment loans have also accompanied PBP processes. Two examples of complementary products are highlighted in Box II.2.

BOX II.2

COLOMBIA'S TRANSPORT REFORM PROGRAM AND NICARAGUA'S ENERGY REFORM PROGRAM

The Bank provided long-term support to Colombia for the process of institutionalizing the National Logistics Policy, especially through a set of investment loans (CO-L1065 and CO0263) approved in 2004 and 2008 to support private participation and concessions in infrastructure. CO-T1214, approved in 2010, also fostered dialogue in the area, supporting trade negotiations and the implementation of trade agreements. In 2011, this work was complemented with the approval of the first loan of the PBP series to support the National Logistics Policy (CO-L1090), which aimed at assisting Colombia in implementing the policy. Several TCs provided parallel support (RE-477): one reimbursable TC (CO-L1109), and six non-reimbursable TCs. To a large extent, however, many of the conditions included

in the PBP loan piggybacked on previously met measures (and the second loan in the series was never pursued).

Likewise, Bank support for the Program to Strengthen the Electricity Sector in Nicaragua, initiated in 2013, was preceded by a series of investment loans—the Electricity Sector Support Program (NI-L1021, NI-L1022, and NI-L1036) and the National Sustainable Electrification and Renewable Energy Program (NI-L1040, NI-L1050, and NI-L1063) in 2010. The PBP series aims to consolidate the progress achieved through those investment loans, promoting further reforms in the areas of financial sustainability, transparency, and development of sustainable energy and regional integration.

Investment Loans and Technical Cooperations related to PBP CO-L1090

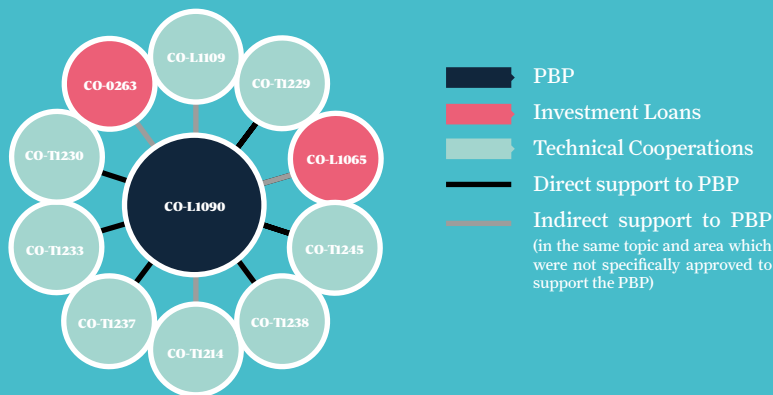


FIGURE II.2. Number of parallel TCs in PBP series



Source: OVE based on 82 PBP series

OVE's analysis suggests that Bank policy-based lending usually accompanies reform processes in areas in which the Bank has accumulated experience and knowledge, continuing a longer-term policy dialogue at the country level. This finding is also compatible with the hypothesis that when countries need quick financial support, the Bank turns to sectors in which it has accumulated know-how so it can respond more expeditiously.

Around 13% of all policy-based operations approved since 1989—roughly a quarter of total policy-based financing—have been cofinanced with other development partners, especially the WB. Most of the cofinancing occurred in the early days of PBLs and, although on a smaller scale, it remained important until about 2005. Since then, the Bank has financed almost all PBLs individually. Similarly, PBL approvals were in the past largely dependent on the borrowing country's having an IMF-supported program in place. This tendency has declined over time, because of both the decreasing presence of IMF-supported programs in LAC and IDB's increasing detachment from IMF assessments (accompanied by expanded in-house analysis).

BENEFITS OF USING PBLs

The importance of PBLs in the Bank's overall lending can be traced to both demand- (i.e., borrower) and supply- (i.e., Bank) related factors. From a demand perspective, PBLs provide fast-disbursing budget support and can have lower transaction costs than investment projects; they usually bring policy advice and capacity building; and they may help governments create consensus for and legitimize their reform agenda. The analysis found that countries' predominant rationale for using PBLs is budget support in times of financial stress. Specifically, countries resort to PBLs to address actual or anticipated financing requirements, but their use increases the most in times of economic shocks. This is especially true in small economies, which tend to be more vulnerable to external economic shocks and for which IDB financing can be decisive to weather a storm. That said, PBLs' countercyclical role has been rather limited, as noted earlier.

From the Bank's perspective, PBLs are faster and cheaper to prepare and to implement than investment projects, and they generate more income per dollar approved. Additionally, as of December 2014, the credit quality of the PBL portfolio, as reflected by the ratings of borrowing member countries, was better than that of the investment portfolio.

PBL disbursements tend to peak at the end of IDB's and countries' fiscal years. This likely reflects the joint incentives to demand and supply this lending instrument, together with incentives created by IDB's annual country programming process to push through project approvals (often followed by disbursements in the case of PBLs) at year-end.

DESIGN AND IMPLEMENTATION

For the in-depth analysis of design and implementation features, OVE drew a stratified random sample of 40 policy-based programs that encompasses 70 loans in 18 countries. The sample was drawn from the population of policy-based programs approved since 2005 in four thematic areas—public sector governance and economic management, social sectors, financial sector, and energy. The sample amounts to half the programs approved in those areas during that period. OVE then analyzed the sample along three dimensions: policy depth, sequencing, and vertical logic (Table II.2).

TABLE II.2. OVE's Approach to PBL Design Features

Dimension	Description
Depth	The extent to which policy conditions are sufficiently critical to trigger, by themselves, an institutional or policy change. Policy conditions that are too process-oriented or easily reversible, or that only indicate intentions, have low depth; conditions that can have immediate (but not lasting) impact are usually considered of medium depth; and conditions that could, by themselves, trigger long-lasting changes in the institutional or policy environment are considered of high depth. The depth dimension includes a progression analysis, which assesses the extent to which policy conditions increase in depth as the reform program advances.
Sequencing	The extent to which the policy conditions included in each tranche of a multi-tranche PBL, or in each loan of a PBP series, follow a logical sequence over time by supporting different stages of the reform process cycle: formulation or design, adoption or approval, implementation, monitoring and evaluation.
Vertical logic	The coherence between conditions and the reform program's objective and results indicators.

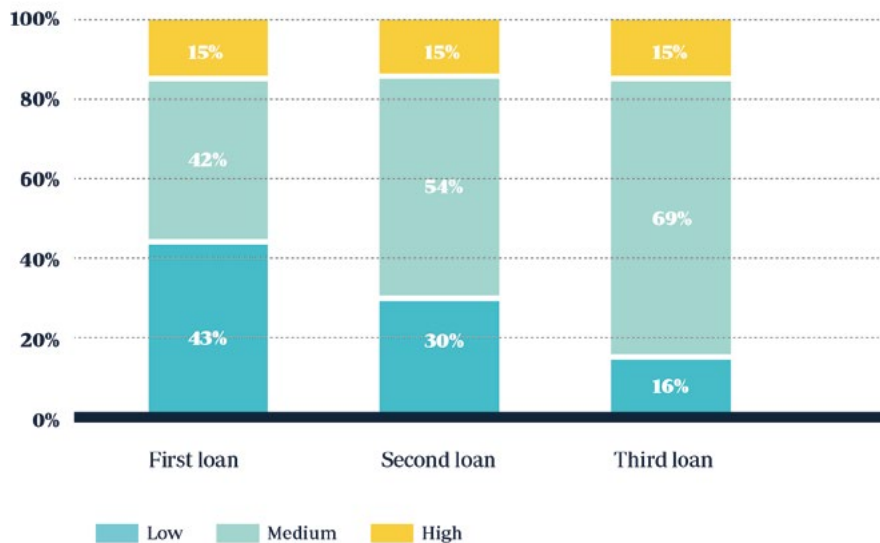
Source: OVE. For further details, see technical note, Annex.

Design. OVE found that the sequencing of conditionality has typically followed the stages of a reform cycle: for both multi-tranche PBLs and PBPs, conditions in the first tranche or loan focus on the earlier stages of a policy reform process (preparation, approval), while a larger proportion of conditions in subsequent tranches or loans focus on implementation. This indicates that on balance the Bank supports a reform process from an early stage and aims at staying through later stages. However, the monitoring and evaluation stage is seldom included as conditionality.

OVE also found that 15% of the conditions in the sample had high depth, 54% had medium depth, and the remainder had low depth. Low-depth conditions call for basic one-off measures or simply express intentions, so that they can hardly be considered “essential for the achievement of expected results,” as expected according to Bank guidelines (CS-3633-1). This suggests that there is scope for reducing the use of low-depth measures as policy conditions in Bank PBLs.

This said, OVE also found that the depth of conditions increases as the reform process advances: 43% of conditions in the first loans of PBP series tend to have low depth, while the proportion decreases to 30% and 16% in the second and third loans, respectively (Figure II.3).

FIGURE II.3. Depth and Loan Order – PBP Series



When analyzing policy and institutional depth, sharp differences arise across countries as well as across programs within countries. In general, though, three findings stand out: (i) how advanced a country is in the pursuit of a reform process at the outset of the program is positively correlated with program depth; (ii) reforms supported in times of crisis are slightly deeper; and (iii) programs in the financial and energy sectors tend to have greater depth than those in the social and public sector management and macroeconomic clusters. However, the fact that PBLs often reward reforms already undertaken complicates the interpretation of these findings.

The analysis found that there is no correlation either between loan size and number of policy conditions or between loan size and depth of the supported reform program.

Implementation. Under the traditional multi-tranche PBL, countries tended to request waivers if they were unable to comply with conditionality. For PBPs countries do not need to resort to waivers, but actual policy conditions frequently diverge from the original indicative triggers.

In addition, many PBP programs are not fully completed (that is, they are “truncated”).³ Of the 82 PBP series approved during 2005-2014, 59 reached a mature stage, and of these 44% have been truncated (Figure II.4). Since higher-depth conditions tend to be concentrated in the later loans of a series, truncation impairs the whole program’s depth. However, the reasons for PBP truncation are case-specific and not clearly related to program depth. Truncation is usually associated with changes in countries’ financing requirements and/or government priorities. In this regard, OVE’s analysis suggests that there may be room to improve the time alignment between Bank support to a reform program and the country’s political cycle.

FIGURE II.4. PBP Series Status, 2005-2014



Source: OVE based on 82 PBP series

3 Building on the definition set out by IDB’s Office of Strategic Planning and Development Effectiveness (SPD), OVE considers that a PBP series has been interrupted, or “truncated”, if one of the following occurs: (a) the government formally requests the discontinuation of at least one operation of the series; (b) there is no loan in the pipeline 24 months after the last disbursement date of the most recent operation; or (c) a pending loan in the series has remained in the pipeline for more than 36 months after the last disbursement date of the most recent operation.

OVE also found that in many cases countries continue with reform efforts after a PBP has been truncated, albeit often at a slower pace. This may call into question the Bank's capacity and incentives to realistically assess—with the borrower—the pace of reforms.

Monitoring and evaluation. The evaluability of PBLs has traditionally been much weaker than that of investment loans, with lower DEM scores at entry. Scores are particularly low in monitoring and evaluation, perhaps reflecting methodological challenges in estimating PBL impact. OVE's review also found that program objectives tend to be poorly linked to meaningful results/outcome indicators, since results matrices focus primarily on activities and outputs.

The monitoring of PBLs has also traditionally been weak. Until recently, for series that were indefinitely postponed or *de facto* suspended, staff usually did not prepare a PCR. Moreover, the fast-disbursing nature of PBLs implies that many loans are never subject to the six-month project monitoring report cycle. The new PCR guidelines approved in August 2014 represent a substantial advancement, since they state that a PCR must be produced even when the series is interrupted or the next operation in the series is postponed indefinitely. Another important change recently introduced to PBLs made the inclusion of economic analysis mandatory.

SUMMARY AND CONCLUDING REMARKS

From a conceptual viewpoint, PBLs have an important role in supporting policy and institutional reforms. PBL resources are fungible—as, ultimately, is much of investment lending. As more LAC countries have gained access to capital markets, IDB has developed more flexible policy-based lending modalities, which have been attractive to borrowers. The use of PBLs has varied greatly across LAC countries, though every country has had at least one PBL since 1990. The share of PBLs in the total SG portfolio shows no significant relationship with countries' income levels or institutional strength indicators.

Historically, there has been a twofold motivation for Bank policy-based lending: to provide borrowing countries with liquidity to help meet their budget and/or balance of payments financing needs, and to help them advance with policy and institutional reforms. The balance between these objectives varies, and the compatibility of those

twin goals cannot be taken for granted. For example, when a country's financing needs are great, the policy elements may take second place. In this regard, OVE found that there is no correlation either between loan size (in absolute and in per capita terms) and number of policy conditions, or between loan size and the depth of the supported reform program. These findings are consistent with the Bank's policy-based lending guidelines, which clarify that loan volume is not necessarily related to the cost of the policy reforms and institutional changes supported by the PBL, but is determined by the country's financing requirements.

As the Bank reviews its lending instruments in 2016, it would be important for the Bank to review its framework and guidance for PBLs. The various provisions that make up the PBL framework have evolved through the years but remain somewhat unclear, and that lack of clarity can translate into weak design. For instance, the Bank's operational guidelines for policy-based lending offer little guidance on what qualifies as a policy or institutional reform, and thus on appropriate policy conditionality. Moreover, the rationale for the specific ceilings for policy-based lending (overall and not by country) has lacked analytical and empirical grounding. In addition, it remains unclear whether PBLs are meant to leverage reforms (that is, bring about reforms that would not otherwise take place to the same extent), support reform implementation (for instance, by providing technical know-how), or reward reforms already undertaken. For example, to what extent should PBLs piggyback on measures undertaken before the start of the operation? How old can measures be, yet still qualify as policy conditions in a Bank PBL?

Regarding loan content, Bank guidance prescribes that policy conditions be critical and as few as possible. Yet OVE found that one-third of policy conditions are of low depth, involving basic one-off measures or expressions of intent – conditions that can hardly be considered essential for the achievement of expected results, as called for in Bank guidelines. Furthermore, the average number of conditions in policy-based lending programs has risen over the last decade, though more conditions has not meant greater depth. TCs might be a better instrument to help countries carry out the basic measures needed to set the ground for a reform program, facilitating greater parsimony in the selection of PBL conditionality.

Finally, regarding implementation, of the 82 PBP series approved between 2005 and 2014, 23 are still active, 33 were completed, and 26 were truncated. Thus the truncation rate to date (the number of truncated series over the sum of completed and truncated series) is 44%. In some countries, truncation has resulted in frequent shifts in the policy

focus of the Bank's PBL. Since medium- and high-depth conditions tend to be concentrated in the second and third loans of a series, the truncation of PBP series dilutes the overall depth of PBP programs (though it does not necessarily signal the end of the country's reform process). Significantly, OVE found a positive relationship between TC use in parallel to a PBP series and the likelihood of completion of the series.

The evaluations reviewed in this Annual Report underscore the role of IDB as an important development partner for LAC countries, and the role of PBLs as a key instrument of Bank support. As economic conditions and the development finance landscape continue to evolve in the region, IDB needs to review and update its toolkit of lending and non-lending instruments to ensure its continued relevance and effectiveness.

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