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IDB's Ninth General Capital Increase: Implementation and Results

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IDB's Ninth General Capital Increase: Implementation and Results

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Acronyms and Abbreviations

ATI	Access to Information
C&D	Small and Vulnerable Countries
CAP	Capital Adequacy Policy
CCLIP	Conditional Credit Line for Investment Projects
CDC	Country Development Challenges
CPDs	Country Programming Documents
CPE	OVE's Country Program Evaluation
CRF	Corporate Results Framework
CS	Country Strategy
DDO	Deferred Drawdown Option
DEF	Development Effectiveness Framework
DEM	Development Effectiveness Matrix
DEO	Development Effectiveness Overview
ETH	Office of Ethics
FFF	Flexible Financing Facility
FFS	Fee-for Services
FMM	Fiscal and Municipal Management
FMP	Financial Management and Procurement Services Office
FSO	Fund for Special Operations
GDP	Gross Domestic Product
ICIM	Independent Consultation and Investigation Mechanism
ICR	Issuer Credit Rating
ICS	Institutional Capacity of the State
IDB	Inter-American Development Bank
IDB-7	IDB's Seventh General Capital Increase
IDB-8	IDB's Eight General Capital Increase
IDB-9	IDB's Ninth General Capital Increase
IIC	Inter-American Investment Corporation
IMA	Independent Macroeconomic Assessment
IMF	International Monetary Fund
IMM	Income Management Model
IT	Information Technology
LAC	Latin America and the Caribbean
LBR	Loan Based on Results
M&E	Monitoring and Evaluation
MBF	Main Business Function
MDBs	Multilateral Development Banks
MIF	Multilateral Investment Fund
MPL	Multi-phase Program Loan
MSA	Macroeconomic Sustainability Assessment
NSG	Non-sovereign-guaranteed
OC	Ordinary Capital
OII	Office of Institutional Integrity
OMJ	Opportunities for the Majority
OVE	Office of Evaluation and Oversight

Acronyms and Abbreviations

PBLs	Policy-based Loans
PBPs	Programmatic Policy-based Loans
PCR	Project Completion Report
PFM	Public Financial Management
PforR	World Bank's Program-for-Results
PMR	Progress Monitoring Report
PROPEF	Project Preparation and Execution Facility
RAC	Risk Adjusted Capital
RBB	Results-based Budgeting
SACP	Stand-alone Credit Profile
SAP	Enterprise Resource Planning System used by the Bank
SCF	Structured Corporate Finance
SFDs	Sector Framework Documents
SG	Sovereign-guaranteed
SWAPs	Sector-wide Approach
TCs	Technical Cooperation Grants
UBC	Unused Borrowing Capacity
VPC	Vice-Presidency for Countries
VPS	Vice-Presidency for Sectors and Knowledge
WB	World Bank

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The IDB-9 Agreement laid out an institutional strategy with two overarching objectives: reducing poverty and inequality and achieving sustainable growth. This evaluation reviews to what extent IDB-9 mandates have been implemented and what challenges remain going forward.
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Executive Summary

In 2010 the IDB's Board of Governors approved the 9th General Capital Increase (IDB-9), adding $70 billion in paid-in and callable capital to IDB's existing $100 billion capital base. Governors tied the capital increase to a series of Bank reforms, further detailed in the "Report on the Ninth General Increase in the Resources of the Inter-American Development Bank" ("IDB-9 Agreement"). The IDB-9 Agreement laid out an institutional strategy with two overarching objectives – reducing poverty and inequality and achieving sustainable growth – and two strategic goals: to address the special needs of the less developed and smaller countries, and foster development through the private sector. It enumerated a broad set of priorities and activities, organized under three headings: "Operationalizing the Institutional Strategy," "What the Bank Does," and "How the Bank Works."

IDB-9 was designed and implemented in a rapidly changing economic and financial context. The IDB-9 process started in the midst of the international financial crisis, and the following years have been difficult ones for LAC economically. Though improvements in macroeconomic management have helped most LAC countries manage the volatility better than in previous decades, falling commodity prices, slowing growth, and persistent problems of violence and rule of law threaten the profound social progress of the early 2000s. On the other hand, increasing international liquidity has made it easier for many LAC countries to tap international financial markets at attractive rates. This, together with fundamental changes in rating agencies' approach to assessing capital adequacy of multilateral development banks, raises longer-term questions about the relevance of IDB's financial model and its competitiveness.

This evaluation reviews IDB's implementation of the IDB-9 mandates and results to date. It follows the themes of OVE's 2013 midterm evaluation (also mandated under IDB-9) and focuses more centrally on "the big picture" – to what extent IDB-9 mandates have been implemented, what has been achieved, and what challenges remain going forward. It is organized around four key intermediate outcomes of IDB-9:

- strategic selectivity in the choice of activities, with a focus on the IDB-9 priority areas;
- client responsiveness and development effectiveness in interactions with clients;
- efficiency, accountability, and transparency in resource use; and
- financial sustainability.

With regard to implementation, OVE finds that IDB has made extensive progress in implementing most of the IDB-9 mandates. The midterm evaluation made ten recommendations (see Box), of which all but the 6th on Haiti were endorsed by the IDB Board. Of these nine, Bank management has made strong progress in implementing seven and more modest progress on two (4 and 9). Progress has also been made in implementing a number of other IDB-9 mandates, including the adoption of results-based budgeting, the country systems agenda, the implementation of new information technology systems (SAP and Convergence) through the Optima program, and the strengthening of the Bank's ability to address issues of fraud and corruption.

The Ten Recommendations of the Midterm Evaluation of IDB-9 Commitments

1. Begin a process to update IDB's institutional and sector strategies and revisit the Corporate Results Framework with an eye to simplification, improved data accuracy, and full knowledge and ownership by Bank staff and other stakeholders.

2. Revisit the formal role and content of Country Strategies and Country Programming Documents to balance the need for strategic selectivity with the demand-driven character of the Bank.

3. Restructure the private sector windows of the Bank to integrate them much better with each other and with the public sector side of the Bank.

4. Undertake further reforms to streamline resource allocation processes and results monitoring for technical cooperation and capacity-building work.

5. Complete the implementation of the Development Effectiveness Framework as envisioned in the Cancun Declaration and IDB-9.

6. Refocus the Haiti program intensively on sustainable poverty reduction and economic growth, moderating short-term pressures for loan approvals and disbursements to take into account the country's absorptive capacity, and providing space for critical yet smaller or slower-disbursing activities.

7. Redesign the Macroeconomic Sustainability Assessment (MSA) process.

8. Reform the Independent Consultation and Investigation Mechanism (ICIM).

9. Revise the policy on information disclosure.

10. Undertake further analysis and scenario testing of the Income Management Model and the Capital

With regard to results, OVE finds that progress toward achieving IDB-9's four intermediate outcomes has been significant though uneven. First, IDB-9 seems to have had only a modest effect on the Bank's strategic selectivity. Neither IDB-9's five mandated sector strategies nor its lending targets appear to have led to meaningful changes in Bank activities. The Bank's C&D country classification is increasingly outdated and is not the best tool to focus the Bank's support on poverty or on the special needs of less developed countries. Indeed, there is little evidence that the Bank focused more on poverty and inequality than it had before (other than in Haiti, where results have been weak to date), though a broad emphasis on economic growth does encompass much of what the IDB does and is also important to poverty reduction. The 2015 private sector merge-out has the potential to strengthen the Bank Group's effectiveness in supporting development through the private sector, but strong leadership will be needed to overcome the centrifugal tendencies inherent in the organizational structure and take advantage of IDB Group synergies to have the strongest impact.

IDB-9 appears to have had a more significant effect on the second outcome, enhanced client responsiveness and development effectiveness. The Bank has developed a comprehensive and flexible set of lending products and has moved toward more integrated country diagnostic work as part of its new approach to country strategies. It has also invested heavily in broader knowledge generation, with an important challenge going forward being to prioritize and streamline this work. Major progress has been made in strengthening tools to measure development effectiveness, though further work is needed to complete the IDB-9 mandates. Macroeconomic safeguards and the Independent Consultation and Investigation Mechanism have been redesigned to correct initial problems under IDB-9. The Bank is also making progress in helping countries develop fiduciary systems and address issues of fraud and corruption, and continued attention is warranted given the importance of strong institutions not only to development outcomes generally but also to the success of Bank support.

Regarding the third outcome, the Bank has made meaningful improvements but there is still room to enhance its efficiency, accountability, and transparency. The Bank has become a larger and more complex organization during IDB-9 – with increasing annual budgets and more staff and consultants doing more things. Many of the Bank's internal processes, systems, and oversight functions – RBB, IT, Ethics, and the Office of Institutional Integrity – have been strengthened, though continued work will be needed to expand their reach and effectiveness. The Bank's 2010 policy on access to information was a major step forward toward greater transparency, and continued progress is being made on tools and training to implement the policy, though progress in measuring or addressing the use of exceptions could be strengthened. Strong leadership and incentives are needed for all of these efforts to translate into further gains in efficiency, accountability, and transparency.

Finally, the Bank has taken proactive and successful steps to address risks to financial sustainability during the IDB-9 period, but it is likely to face increased challenges of competitiveness that could threaten the currently strong financial stance going forward. LAC countries are increasingly able to access financial markets, often at lower cost than borrowing from the Bank. While current market conditions are particularly favorable, these trends are likely to continue over time as LAC countries grow and develop. IDB will need to increasingly scrutinize its cost structure and the value-added of its financial and non-financial products if it is to stay relevant to borrowers across the LAC region.

OVE offers five broad lessons for IDB emerging from this evaluation:

- Lending patterns and trends in the Bank tend to change slowly from year to year, primarily in response to country demand and country conditions, and top-down lending mandates are rarely effective in this context. If the IDB Governors decide to pursue another capital increase in the future, they are advised to weigh the costs and benefits of top-down mandates and consider carefully their relevance and likelihood of success in the context in which the Bank operates.

- IDB-9's heightened attention to the measurement and documentation of results was well-placed, but further work is needed to make it a reality. The Development Effectiveness Framework is a strong set of tools but has still not been fully implemented as intended. It is critical for IDB to monitor, evaluate, and report clearly and accurately on development results if it expects to achieve them, and renewed effort to meaningfully implement the DEF is warranted.

- One of the Bank's most important but difficult challenges – both in supporting development in LAC and in ensuring success in its own projects – is to help countries strengthen institutional capacity and governance. Despite IDB-9's emphasis on poverty, institutional strengthening, and anticorruption, IDB has had great difficulty achieving results in countries with weak governance and institutional capacity. A renewed look at IDB project designs and at staff incentives to deliver results in these settings – and more generally at IDB's ability to support countries in improving governance and strengthening institutional capacity – is warranted.

- Promoting openness and transparency is a worthy goal of all MDBs, and IDB should make a renewed push in this direction. IDB is a public organization funded with public money serving public and humanitarian ends, and citizens of both borrowing and funding countries deserve to know how their funds are being spent. IDB's reputation is already strong, and its credibility will only improve with increasing openness and transparency.

- IDB is likely to face increasing challenges of relevance and competitiveness as LAC countries continue to develop, and greater consensus is needed on what kind of institution IDB wants to be. OVE's interviews for this evaluation highlighted the wide variety of views among Bank stakeholders on what IDB should seek to be.

The IDB will emerge from IDB-9 as a stronger organization than it was in 2010. Though IDB-9 was overly prescriptive in some areas, it led the Bank to focus more on results and accountability and to improve many aspects of how it works. The work is not yet complete, however, and IDB-9's four intermediate objectives remain highly relevant. IDB should continue to build on the successes it has achieved while moving proactively to develop a consensus on the kind of Bank it wants to become.

IDB-9 was designed and implemented during time of increasing economic stress in LAC. The IDB-9 process started in the midst of the international financial crisis, and the following years have been difficult ones for the region economically.
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1 Introduction

At the 2010 Annual Meeting of the Inter-American Development Bank (IDB, or the Bank), the Board of Governors issued the "Cancun Declaration" (AB-2728), agreeing to a process leading to IDB's Ninth General Capital Increase (IDB-9). Governors tied the capital increase to a series of Bank reforms, further detailed in the "Report on the Ninth General Increase in the Resources of the Inter-American Development Bank" ("IDB-9 Agreement," AB-2764), subsequently adopted by Governors as part of the resolution inviting member countries to vote on IDB-9.

The IDB-9 Agreement recognized the need to keep the IDB relevant and competitive in the Latin America and Caribbean (LAC) region. It laid out an institutional strategy with two overarching objectives – reducing poverty and inequality and achieving sustainable growth – and two strategic goals: to address the special needs of the less developed and smaller countries, and to foster development through the private sector. It enumerated a broad set of priorities and activities, organized under three headings: "Operationalizing the Institutional Strategy," "What the Bank Does," and "How the Bank Works." These priorities and activities incorporated the 13 specific requirements listed in the Cancun Declaration into a broader framework with a wider range of mandates.

The IDB-9 Agreement included a requirement that the Office of Evaluation and Oversight (OVE) conduct a midterm review to determine to what extent IDB was implementing the IDB-9 mandates fully and effectively. OVE undertook the review during 2012 and delivered it to the Board in December 2012.[1] The evaluation's broad conclusion was that "Management has invested heavily in efforts to implement the IDB-9 requirements. The requirement of 'full implementation' has been met or is in the process of being met on most fronts…. The progress toward 'effective implementation' has been more mixed. Likely effectiveness varies widely across areas, with some moving forward well and others more slowly, and with a few having little impact or even imposing costs on the organization." The evaluation's 10 recommendations are listed in Box 1.1.

The institutional strategy laid out in the IDB-9 Agreement extended until 2015, when the accomplishments under the strategy and the IDB-9 Results Framework were to be evaluated and a follow-on strategy was to be adopted. The Results Framework specified 2015 as the target date for achieving many IDB-9 mandates, in line with the strategy period. In 2016, the Board of Directors requested that OVE include an IDB-9 evaluation in its 2017-18 work program.

Box 1.1. The Ten Recommendations of the Midterm Evaluation of IDB-9 Commitments

1. Begin a process to update IDB's institutional and sector strategies and revisit the Corporate Results Framework with an eye to simplification, improved data accuracy, and full knowledge and ownership by Bank staff and other stakeholders.

2. Revisit the formal role and content of Country Strategies and Country Programming Documents to balance the need for strategic selectivity with the demand-driven character of the Bank.

3. Restructure the private sector windows of the Bank to integrate them much better with each other and with the public sector side of the Bank.

4. Undertake further reforms to streamline resource allocation processes and results monitoring for technical cooperation and capacity-building work.

5. Complete the implementation of the Development Effectiveness Framework as envisioned in the Cancun Declaration and IDB-9.

6. Refocus the Haiti program intensively on sustainable poverty reduction and economic growth, moderating short-term pressures for loan approvals and disbursements to take into account the country's absorptive capacity, and providing space for critical yet smaller or slower-disbursing activities.

7. Redesign the Macroeconomic Sustainability Assessment (MSA) process.

8. Reform the Independent Consultation and Investigation Mechanism (ICIM).

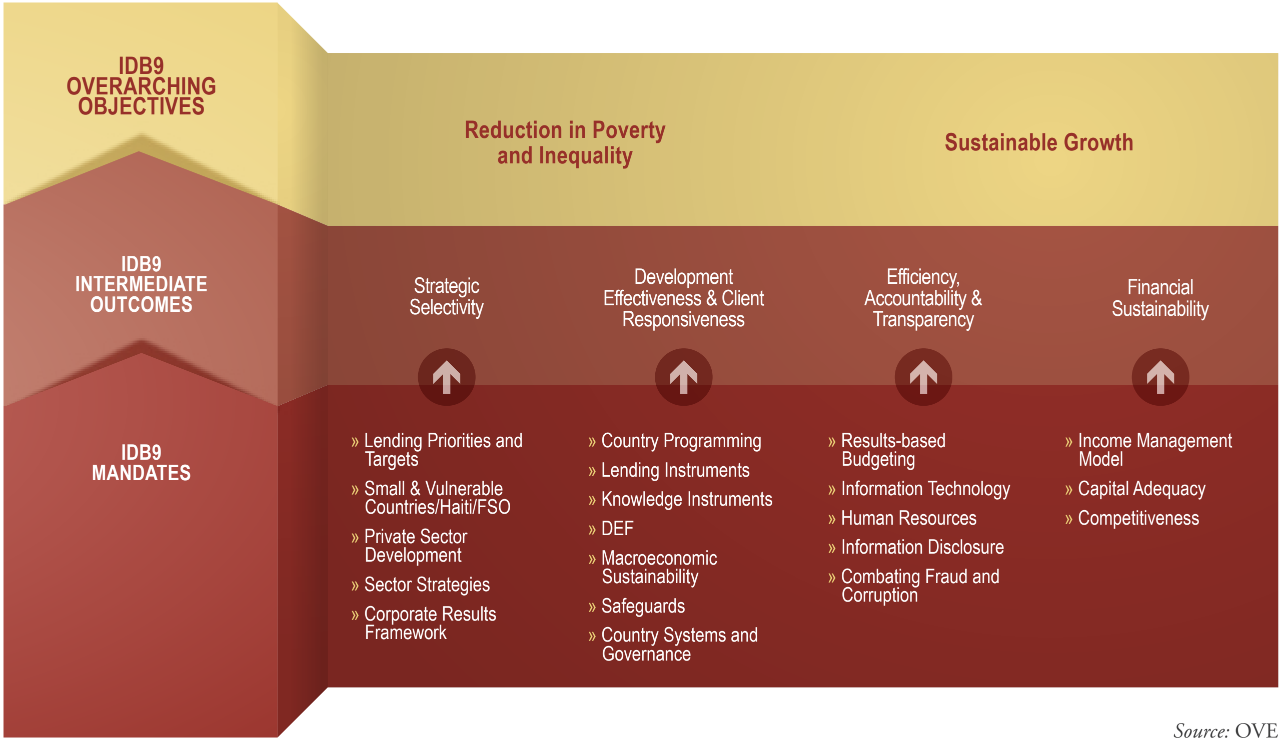
9. Revise the policy on information disclosure.

10. Undertake further analysis and scenario testing of the Income Management Model and the Capital Adequacy rules.

A. Evaluation framework

This evaluation follows the themes of the midterm evaluation but focuses more centrally on "the big picture" – to what extent IDB-9 mandates have been implemented, what has been achieved, and what challenges remain going forward. It is organized around four key intermediate outcomes for IDB that underlay the mandates in IDB-9: (i) strategic selectivity in the choice of activities, with a focus on the IDB-9 priority areas; (ii) client responsiveness and development effectiveness in interactions with clients; (iii) efficiency, accountability, and transparency in resource use; and (iv) financial sustainability, including preservation of the AAA credit rating. The conceptual framework in Figure 1.1, developed by OVE drawing on key IDB-9 documents, shows how the various IDB-9 mandates map into these intermediate outcomes and in turn into IDB-9's overarching objectives of sustainable growth and reduced poverty and inequality.

Figure 1.1 IDB-9 Evaluation Conceptual Framework



Source: OVE

This evaluation addresses the following three overarching questions:

- To what extent has the Bank implemented the commitments agreed to under IDB-9?
- To what extent is the Bank's implementation of these commitments contributing to the achievement of four key intermediate outcomes expected of IDB-9?
    - To what extent is the Bank's implementation of IDB-9 commitments enhancing the Bank's *strategic selectivity*?
    - To what extent is the Bank's implementation of IDB-9 commitments promoting enhanced *client responsiveness* and *development effectiveness*?
    - To what extent is the Bank's implementation of IDB-9 commitments promoting greater Bank *efficiency, accountability, and transparency*?
    - To what extent is the Bank's implementation of IDB-9 commitments enhancing the Bank's *financial sustainability*?

This evaluation is organized around four key intermediate outcomes for IDB that underlay the mandates in IDB-9: strategic selectivity in the choice of activities; client responsiveness; efficiency, accountability, and transparency in resource use, and financial sustainability.

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- What lessons can be drawn from the Bank's experience with IDB-9 for Bank Group priorities, strategies, and activities going forward?

OVE's team analyzed the Bank's operational and knowledge portfolio over the 2010-17 period, studied Bank documents related to implementation of the various IDB-9 mandates, conducted survey of staff, and undertook extensive interviews with Bank managers and staff. It also drew on the findings of other OVE evaluations of relevance to the topics covered. More details on specific topics are available in background notes linked to this document and in other evaluations referenced in this report.

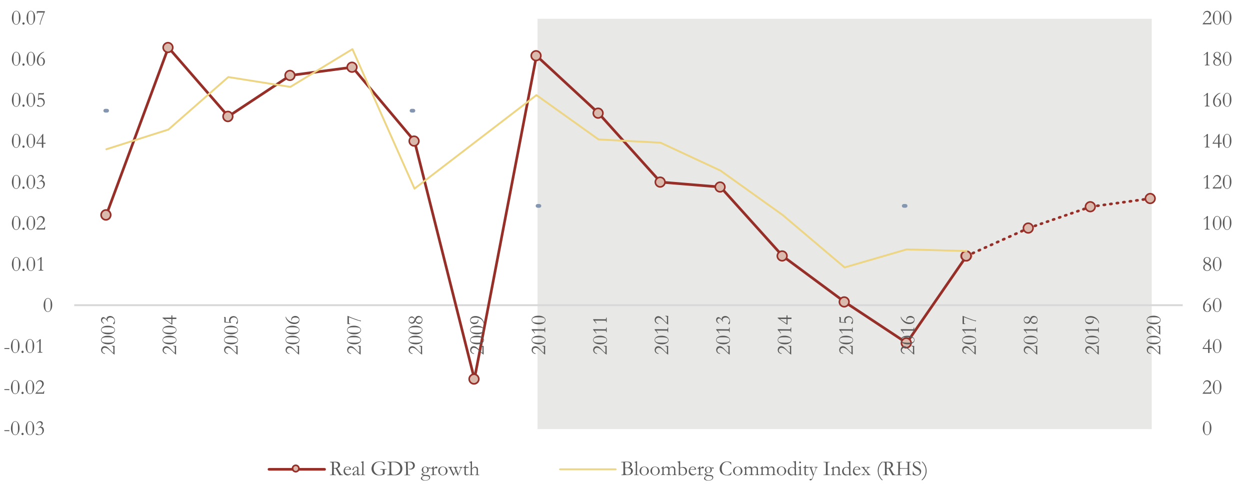
B. The context: Economic and financial developments during IDB-9

IDB-9 was designed and implemented during a time of increasing economic stress in LAC. The IDB-9 process started in the midst of the international financial crisis, and the following years have been difficult ones for the region economically. The fall of commodity prices brought a continuous deceleration in the region's gross domestic product (GDP) growth, which reached negative territory in 2015 (Figure 1.2). South American economies were especially affected by this terms-of-trade shock. At the same time, capital flows became more volatile.

Latin American economies have shown increasing resilience to economic downturns over time, which has also helped in this recent period. Strong economic fundamentals and increased competence in implementing countercyclical fiscal and monetary policies helped the region withstand the 2008 global financial crisis, whose effects were less adverse in LAC than in some developed economies, and milder than during previous financial contagion episodes.[2] Similarly, LAC's macroeconomic policy frameworks have allowed for orderly adjustments in response to the most recent terms-of-trade shock, which most of the region has resisted without major fiscal or financial crises.

Yet the recent economic slowdown has still had important implications, especially for the fiscal position of commodity-dependent economies in the region. Lower revenues have led to increasing primary fiscal deficits, from 0.1% in 2013 to 2.7% in 2016,[3] and higher public debt, from 49% to 58% of GDP over the same horizon. Although some LAC countries reformed tax systems to increase revenues, in many countries worsening fiscal balances have led to declining public investment in both physical and human capital. The economic downturn has also led to downgrades in the credit ratings of some important IDB borrowers.

Figure 1.2 Latin America and the Caribbean Real GDP Growth and Commodity Prices (Annual percent change)



Note: The shaded area represents the post IDB-9 period; the dotted lines are period averages; and the dashed lines depict International Monetary Fund (IMF) growth projections.
Source: Bloomberg and IMF data mapper at http://www.imf.org/external/datamapper/NGDP_RPCH@WEO/WE/ADVEC/EURO/CHN/WE

Lower public and private investment levels, combined with structural weaknesses and difficult business environments, have hurt the region's competitiveness and growth potential. Underinvestment has affected labor productivity and trade integration, albeit to different extents in different countries, with negative implications for the region's competitiveness and long-term growth. Labor productivity in LAC stood at

The IDB-9 Agreement recognized the need to keep the IDB relevant and competitive in the Latin America and Caribbean region.
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around 30% of that in the U.S. throughout 2010-2016 and is increasingly lagging behind that of high-growth countries in Asia.[4]

The economic slowdown has also threatened the profound social progress most LAC countries had made during the early 2000s. The economic prosperity of the early 2000s, coupled with active social policies, led to a significant reduction in poverty and income inequality and an expansion in the middle class.[5] However, during the IDB-9 period, unemployment and informality have increased while working conditions have deteriorated and real wages have fallen.[6] Education outcomes continue to lag behind those of other regions, with some countries seeing little or no improvement in scores on international tests during the IDB-9 period. Poverty rates, which had continued to show a strong declining trend during the first half of the IDB-9 period, increased in 2015, and the share of people belonging to the middle class fell for the first time since the commodity boom began.[7]

Crime and violence and weak rule of law continue to be major challenges in LAC, and recent corruption scandals have destabilized political systems and underscored citizens' frustration with unaccountable government. LAC remains the most violent region of the world, though with variation across countries. In addition to their human toll, crime and corruption negatively affect the business environment and threaten long-term growth.

There have also been important changes in the financial context during IDB-9. First, high levels of liquidity and the compression of lending spreads after the financial crisis have allowed many more LAC countries to gain access to financial markets and to reap the benefits of low world interest rates. Second, IDB-9 implementation coincided with a fundamental change in the rating agencies' approach to assessing capital adequacy of multilateral development banks (MDBs), which undermined the relevance of the basic assumptions on which IDB-9's financial package had been designed. These changes in the financial context are discussed in greater detail in Chapter 5.

2

IDB-9 put a special focus on Haiti, the poorest country in the Western Hemisphere and one that had suffered a devastating earthquake in 2010. IDB-9 mandated debt relief of US$447 million, new grant financing of US$ million annually through 2020, and catalytic role for the Bank in mobilizing additional funding from other sources.
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2 Strategic Selectivity

A first intermediate outcome expected of IDB-9 was strategic selectivity – that is, ensuring that the Bank focused on issues and activities with high development impact and high Bank value-added. The IDB-9 Agreement emphasized the need to put forth "a clear vision of the Bank's priorities and how to meet them, as well as the identification of, and plans to build upon, its comparative advantages."

The Agreement laid out two overarching objectives—reducing poverty and inequality and achieving sustainable growth—and two strategic goals—to address the special needs of the less developed and smaller countries and to foster development through the private sector. It then specified ***five sector priorities*** aligned with these objectives and goals: social policy for equity and productivity; infrastructure for competitiveness and social welfare; institutions for growth and social welfare; competitive regional and global international integration; and environmental protection, climate change, renewable energy, and food security. It specified a number of ***lending targets*** related to these sector priorities, as well as a target of 35% of total lending for ***small and vulnerable countries***. It also mandated that IDB strengthen the ***Fund for Special Operations*** (FSO) and transfer US$200 million annually to the IDB Grant Facility through 2020 to provide non-reimbursable resources to ***Haiti***. With regard to development through the ***private sector***, it mandated that non-sovereign-guaranteed (NSG) operations be expanded up to 20% of total Bank equity, be aligned with corporate priorities, and be better coordinated between the NSG windows. ***Sector strategies*** were to be presented for priority areas, and progress was to be monitored through the ***Corporate Results Framework*** (CRF) (Box 2.1). The relevance and implementation of these strategic mandates and tools is reviewed in this chapter.

It is important to note that while the IDB-9 Agreement imposed many specific mandates to advance its strategic objectives, the objectives themselves were not particularly focused or selective. Its two overarching objectives—reducing poverty and inequality and achieving sustainable growth—were very broad, and the strategic focus on small and vulnerable countries and development through the private sector continued from IDB-8. The five thematic priorities covered virtually all the sectors the IDB was already engaged in. The main innovation was the heavy emphasis on new debt relief and grants to Haiti.

Box 2.1. OVE's Assessment of IDB-9 Lending Targets

OVE's midterm evaluation and its evaluations of transnational programs (RE-415), agriculture (RE-291-2), and climate change (RE-459), carried out around the same time, reviewed the classification system IDB used to report on IDB-9 lending targets. In general, these evaluations found that IDB's guidelines for classifying projects under particular categories were too broad. For example, all projects in human development sectors were automatically classified under poverty, even though not all of these projects in reality reached or even targeted the poor. Similarly, all water and sanitation and environmental projects were automatically classified under climate change, sustainable energy, and environmental sustainability. OVE's 2013 evaluation on transnational programs found a much smaller share of Bank projects were regional projects than had been classified under trade and integration. A 2014 OVE evaluation on agriculture found 38% of the projects in the "AG" portfolio explicitly targeted the poor, whereas the Bank automatically classified all agricultural projects as poverty-oriented. Because of these weaknesses in classification, it is unclear that IDB reached the lending targets, if rigorously defined, in 2015.

More recently, IDB has substantially improved its ability to report on progress toward a new target – the goal of increasing the financing of projects addressing climate change to 30% of IDB's and IIC's combined approvals by end-2020, subject to demand from borrowing countries and clients and access to external sources of concessional financing (IIC/AG-2/16). The monitoring system for this goal, set in the context of the Paris Climate Agreement, has been carefully designed and is consistent across multilateral development banks.

A. Lending targets and trends during IDB-9

The IDB-9 Agreement included expectations for the amount of overall lending and specific targets for lending in priority areas. It anticipated that loan approvals financed with ordinary capital (OC)—including both sovereign-guaranteed (SG) and non-sovereign-guaranteed (NSG) lending—would average US$12 billion per year for the 2011-2020 period. The lending targets included percentages of lending dedicated to small and vulnerable countries and lending to support poverty reduction, climate change and environmental sustainability, and regional integration (Table 2.1).

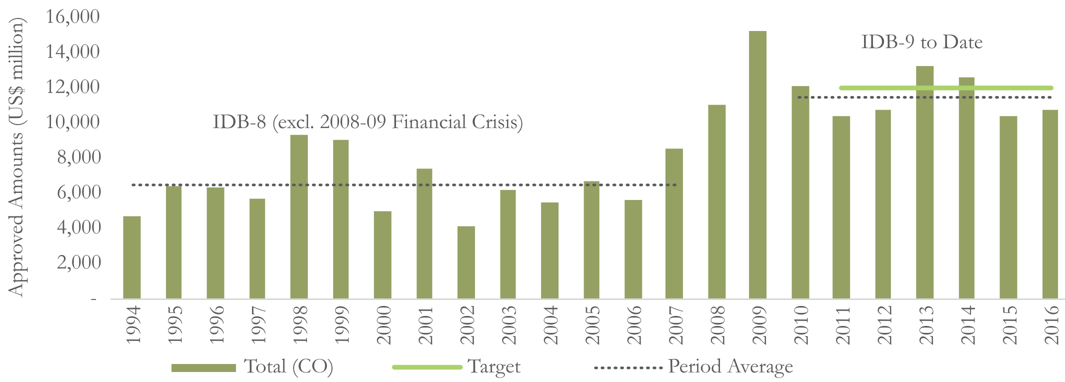
Table 2.1. IDB-9 Lending Targets

Lending program indicators	Percent of total lending	
	Baseline 2006 - 2009	Target 2015
1.1 Lending to small and vulnerable countries	27	35
1.2 Lending for poverty reduction and equity enhancement	40	50
1.3 Lending to support climate change initiatives, sustainable energy (including renewable), and environmental sustainability	5	25
1.4 Lending to support regional cooperation and integration	10	15

Note: Since projects could qualify for more than one lending category, the percentages did not add to 100%.
Source: IDB-9 Agreement

Lending has been roughly in line with IDB-9 expectations and significantly above IDB-8 levels. During 2011-2016 annual approvals reached 95% of the target on average, ranging from a maximum of US$13.3 billion in 2013 to a minimum of US$10.4 billion in 2015—well above pre-IDB-9 figures (Figure 2.1).

Figure 2.1 Annual OC Approvals (US$ million), 1994-2016



Note: Includes SG and NSG lending financed with OC.
Source: OVE, based on Annual Reports.

The overall 35% target for lending to small and vulnerable countries was met according to the Bank's definitions, as discussed in the next section. At the country level, lending shifted somewhat from larger toward smaller, though not necessarily poorer, economies in the region. Approvals to Argentina, Brazil, Colombia, Mexico, and Peru decreased from 63% of total SG lending before IDB-9 to 56% during 2012-15. Conversely, smaller economies accounted for 44% of total SG lending in 2012-2015, compared to 37% in 2006-2009. Average annual per capita approvals by country for these 4-year periods before and after IDB-9 are shown in Figure 2.2. Some of the small economies with increases in lending (such as Bolivia and Nicaragua) are lower-middle-income countries, while others (such as Barbados, Panama, Trinidad and Tobago, and Uruguay) are higher-middle-income, as discussed in the next section.[8] Notwithstanding these changes, trends in annual approvals by country tend to exhibit considerable inertia over time.[9]

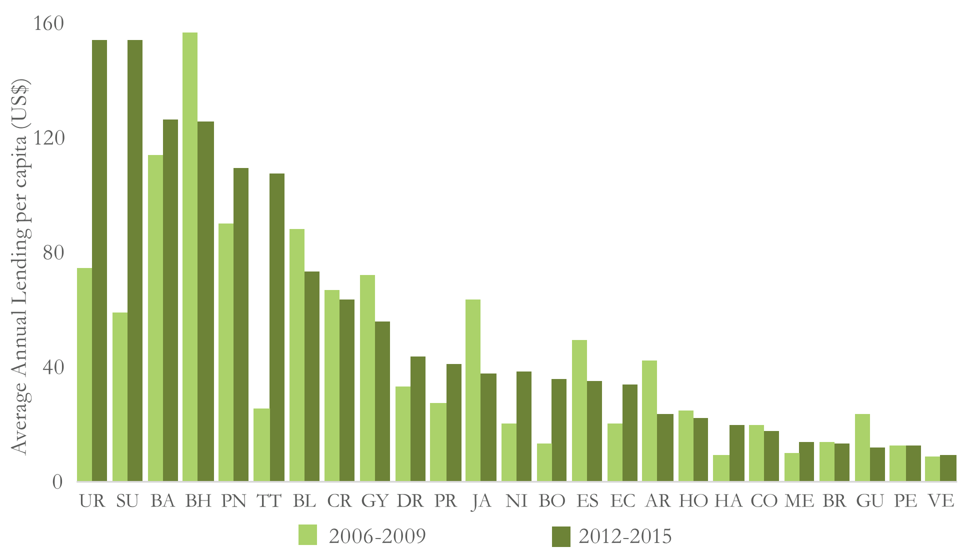


Figure 2.2

Average Per Capita Annual Approvals Before and After IDB-9

Source: OVE, based on Data Warehouse.

IDB management asserts that the three thematic lending targets shown in Table 2.1 were also met or surpassed in 2015, though OVE's midterm evaluation identified flaws in the design and implementation of the targets that led to overestimating compliance (Box 2.1). More generally, OVE questioned the wisdom of top-down lending targets, given the distortionary incentives they tend to create. In the updated institutional strategy thematic lending targets have been discontinued, though the target for small and vulnerable countries and a climate change target, set in the context of the Paris Climate Agreement, remain.

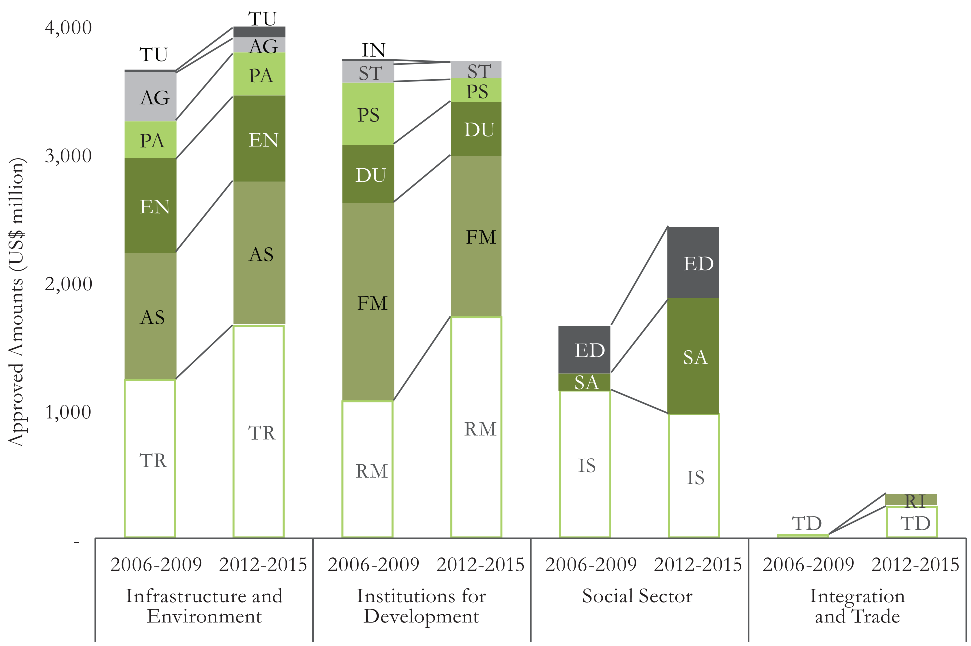
According to the sector categorization used by the Bank (Figure 2.3), lending for transport, reform and modernization of the state, health, and integration and trade increased substantially during 2012-15 (the last from a very low base). Though these trends were broadly consistent with IDB-9 thematic priorities, it is not clear to what extent those priorities were a driving force.

Figure 2.3

SG Lending by Sector, Annual averages 2006-2009 vs. 2012-2015

Note: IDB's project classification system does not fully coincide with the Bank's divisional structure. The 16 sectors are EN: Energy; PA: Environment and Natural Disasters; AS: Water and Sanitation; TR: Transportation; AG: Agriculture and Rural Development; TU: Sustainable Tourism; PS: Private Sector and SME Development; RM: Reform/Modernization of the State; DU: Urban Development and Housing; FM: Financial Markets; ST: Science and Technology; IS: Social Investment; SA: Health; ED: Education; TD: Trade; RI: Regional Integration.

Source: OVE, based on Data Warehouse.



B. Small and vulnerable countries

As noted above, the first strategic goal of IDB-9 was to address the special needs of less developed and smaller countries. This followed a long history of IDB attention to this topic, with indicative lending targets, first for lending to low income populations and later for "C&D"[10] countries, included in every recapitalization since IDB-5 (Table 2.2). The targets for C&D countries were not met in IDB-7 or IDB-8, leading the Bank to create "Action Plan C+D" in 1998 to identify and address bottlenecks to absorption of IDB funds. This was converted into the "small and vulnerable countries" special program in IDB-9, funded fully from ordinary capital.[11] In addition to the lending target and special program, the IDB-9 Agreement provided for special grant funding for Haiti and mentioned briefly the Fund for Special Operations (FSO), as described below.

Table 2.2. Lending Targets in Capital Increases (%)

Priority areas	IDB-5	IDB-6	IDB-7	IDB-8	IDB-9
Low-income populations / poverty reduction and equity	50	50	50	40*	50
C&D/small and vulnerable countries			35	35	35
Regional integration					15
Climate change and environmental initiatives					25

Source: IDB capital increase documents. Targets are for the percentage of overall lending in volume terms.
*IDB-8's target was 40% of total lending (and 50% of total loans) for social needs, equity, and poverty reduction.

1. Support to C&D countries

There is a fundamental inconsistency in this lending target and associated language in the IDB-9 Agreement, as it obscures important differences between C&D countries, "less developed and smaller" countries (in the strategic goal), "small and vulnerable" countries (in the lending target and special program), and where the poor live in LAC. The text in the IDB-9 Agreement explaining the strategic goal —to "address the special needs of the less developed and smaller countries" —equates this classification with poverty:

> To pursue equity and sustainable development in the LAC region as a whole, it is essential to address the needs of the less developed and small countries. Just as the countries in the region lag behind those of the developed world and the most dynamic emerging countries in several dimensions, there are also significant intra-regional development gaps. Countries such as Bolivia, Guatemala, Guyana, Haiti, Honduras, Nicaragua and Paraguay have a per capita GDP that is only a quarter of the regional average, and their poverty rates are nearly twice as high as the average for the region as a whole. These gaps are reflected in most indicators of social welfare and access to services. It has been, and will continue to be, a priority for the Bank to support the efforts of these countries to accelerate their pace of development.

Yet in reality the main characteristic that clearly differentiates C&D countries from A and B ones is the overall size of the economy, as A and B countries are larger than C&D countries. There is only a modest relation with per capita GDP, economic vulnerability, vulnerability to natural disasters, level of development, or strength of governance and institutions. Indeed, the C&D grouping includes a wide variety of countries with distinctively different development challenges, ranging from Haiti to Uruguay.

Given this categorization, meeting the 35% lending target for C&D countries in 2015 did not mean that the IDB-9 program had succeeded in addressing its overarching objective of reducing poverty and inequality or its strategic goal of addressing the special needs of the less developed and smaller countries. Indeed, much of the increase in lending approvals to C&D countries in IDB-9 went to the higher-income countries in that grouping, most notably Trinidad and Tobago, Uruguay, and Suriname. OVE's calculations indicate that the average share of IDB's total SG lending going to each high-income C&D country more than doubled from 1.1% per country in 2006-2009 to 2.3% in 2012-2015, while the average share going to each non-high-income C&D countries increased by 21% — from 1.9% per country to 2.3% — over the same period.

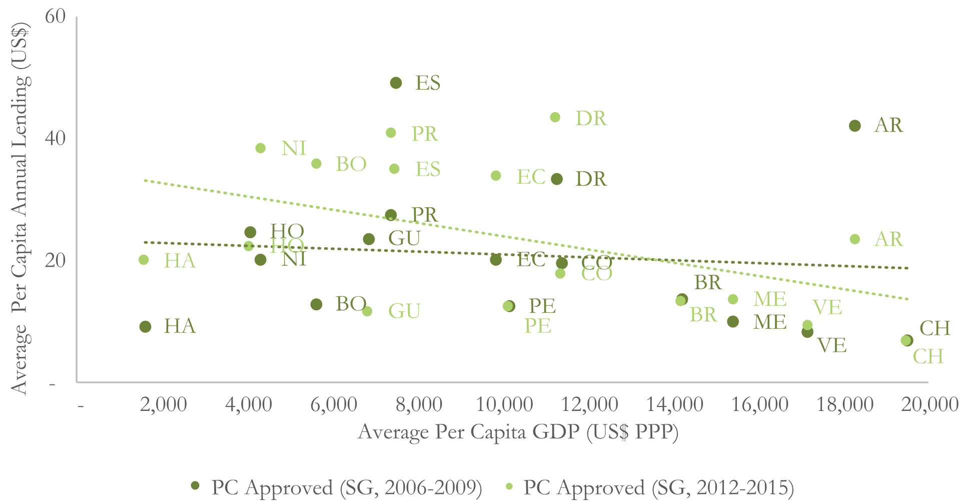
The same pattern holds on a per capita basis in smaller countries. Figure 2.4 plots average lending per capita before and after IDB-9 against per capita GDP, showing the relationship separately for larger and small countries. Among larger countries (with populations over five million) the Bank has approved relatively more lending on a per capita basis to countries with lower per capita income, but per capita SG lending has been positively associated with per capita income in countries with populations below five million.

Figure 2.4

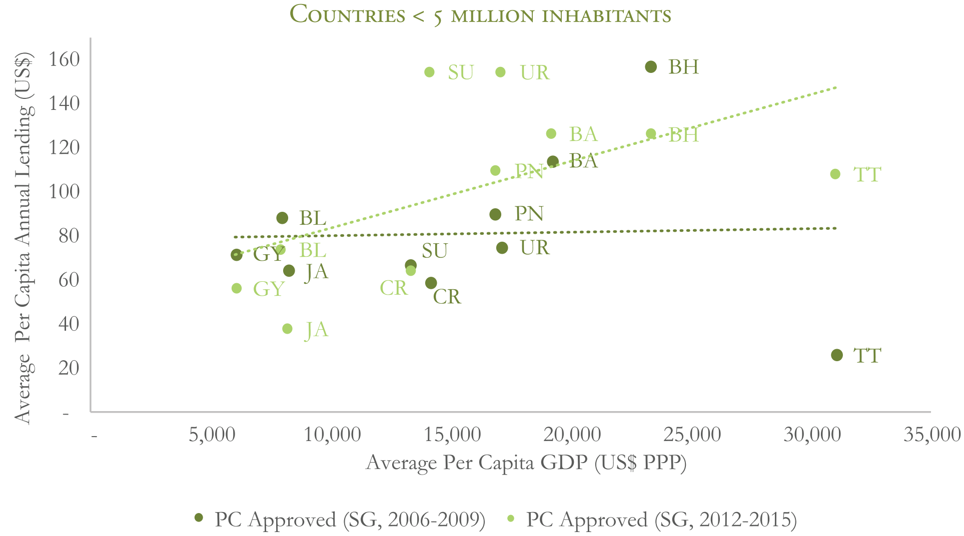
Relationship between per capita Income and per capita SG approvals, 2006-2009 vs. 2012-2015

Source: OVE, based on Data Warehouse and the World Bank.

Countries > 5 million inhabitants



Countries < 5 million inhabitants



2. Support to the Fund for Special Operations

The main window used by IDB to provide concessional financing to low-income countries has been the Fund for Special Operations (FSO), which was only briefly mentioned in the IDB-9 Agreement:

> In order to meet these objectives, IDB-9 will strengthen the Fund for Special Operations as an important tool to mobilize resources in support of the less developed countries in the LAC region. To this end, the FSO share of administrative expenses will be reduced to 3%, funding for the non-reimbursable technical cooperation will be transferred to the OC, and the transfers from FSO to the Grant Facility will be discontinued. In addition, US$479 million in new contributions to the FSO will be made to provide full debt relief and additional resources to Haiti, and ensure the sustainability of the FSO until 2020. To ensure efficient use of FSO resources, the current blend of OC and FSO financing will be maintained, preserving the degree of concessionality consistent with the debt sustainability framework of each country. Governors, in accordance with the Cancún Declaration, will review the need for a new FSO replenishment before 2020.

The specific FSO-related mandates were met and in 2017 the Governors decided to merge the resources of the FSO with the OC. The merger allowed concessionality to be maintained in the lending terms for former FSO-eligible borrowers and has helped to strengthen the Bank's capital position (as discussed in Chapter 5).

3. Support to Haiti

IDB-9 put a special focus on Haiti, the poorest country in the Western Hemisphere and one that had suffered a devastating earthquake in 2010. IDB-9 mandated debt relief of US$447 million, new grant financing of US$200 million annually through 2020, and a catalytic role for the Bank in mobilizing additional funding from other sources.

The Bank has implemented the IDB-9 financial mandates for Haiti, with some midcourse adjustments. It immediately forgave the remainder of Haiti's debt, US$447 million, concluding an effort that had been under way since 2004 and resulting in total debt relief of US$1.1 billion for the country. Specifically, the Bank made transfers from OC income of US$200 million annually from 2011 to 2015, for a total of US$1.0 billion. Although disbursements tripled over that period, they lagged behind approvals, and by 2015 the undisbursed balance in the Facility had risen to US$539 million. In 2016, Governors approved a "Proposal for Optimizing the IDB Grant Facility Transfer from the OC" (which had been established in 2007, as part of the 2007 debt forgiveness package) with the result that OC income transfers were postponed in 2016 and 2017. Elections and the

One of IDB-9 strategic goals was to foster development thorough the private sector.
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installation of a new government in Haiti have delayed new approvals in 2016 and 2017, and disbursements on existing loans have also been lower than expected. Transfers are expected to resume in 2019, based on projections of approvals and disbursements in the new Country Strategy (CS).

The Bank also played an active role in catalyzing resources in the first few years after the earthquake. Between 2011 and 2015, Bank-administered cofinancing totaled US$153.6 million (US$0.14 per dollar approved), slightly above the amount in 2005-2009 (US$0.11 per dollar approved). The Bank also participated actively in donor consultations during a time of unprecedented flows of US$3.4 billion in international aid to Haiti, though by 2014-2015 international aid had returned to its 2005-2008 levels.[12]

The Bank created a new department for Haiti to manage this large and complex program. Operating expenses for the program increased from US$46,000 per US$1 million approved in 2011 to US$61,000 in 2015. The department was eliminated in 2017, and the Haiti program was merged into the Country Department for Central America, Mexico, Panama, and the Dominican Republic.

The IDB's program has achieved limited results in Haiti, with significant challenges in the operational and financial sustainability of its investments. OVE's Country Program Evaluation (CPE) for 2011-2015 (RE-494) found that the Bank's country program did not adequately take into account the challenges associated with Haiti's fragility and limited institutional capacity. As a result, the Bank ended up financing an overly ambitious and oversized operational program and failed to fully assess the costs and benefits of the interventions. The investment portfolio made progress in infrastructure, albeit with differences among sectors. Coverage and expansion targets were not met in transport and energy, though results in agriculture and water and sanitation were more positive. There were also significant governance problems and, probably related, major cost overruns in the program. Policy-based grants supported policy dialogue at the sector level but did not address some core policy reform needs. Funding for private sector development went mostly to the construction of the Caracol Industrial Park. The program made progress in delivering some high-quality infrastructure, though job creation during the first few years of operation did not met expectations.

The CPE also found that IDB had financed salaries for an estimated 715 consultants and staff at various ministries and government agencies to help with the implementation of its program. While Haiti's particular situation may have justified this type of financial support at an initial stage, these resources create dysfunctional incentives in government agencies as well as corruption and fiscal sustainability risks. OVE recommended that the IDB develop a clear exit strategy.

The CPE also found that IDB-9's move to large amounts of grant financing negatively affected the incentives that guide Bank-client relations. Country ownership and commitment is normally expressed in a country's willingness to borrow and repay, and grants eliminate that measure of commitment. In addition, Bank grant resources were not systematically included in the country's budget planning process until 2014, undermining the Government's fiscal management and discipline.

Haiti has been in a prolonged transition to a new government during the past two years, and no new Bank non-emergency operations were approved in 2016 and early 2017. This has provided an opportunity to begin to rationalize the IDB program and consider new approaches to implementation. IDBG's new country strategy, approved by the Board in November 2017, addresses most of the critical issues identified in the evaluation. Haiti's economic outlook remains very uncertain, and IDB remains a critical partner in these very challenging times.

C. Support to the private sector

IDB-9's second strategic goal, in addition to supporting the needs of smaller and less developed countries, was to foster development through the private sector. OVE's IDB-9 midterm evaluation pointed to this area as one in critical need of reformulation:

> …the strategic rationale of the Bank Group's private sector activities is uncertain, and they are poorly coordinated across four separate windows

> (despite considerable Management effort at coordination). They rarely take advantage of potential synergies with the Bank's public sector work, and this is costly in terms of missed opportunities—whether in stimulating public-private partnerships (which will be critical in attracting needed private infrastructure investment in LAC) or in strengthening financial systems or undertaking other reforms where both public and private actions are needed.

One of the midterm evaluation's recommendations was to "restructure the private sector windows of the Bank to integrate them much better with each other and with the public sector side of the Bank."

In the years that followed the IDB-9 Agreement, lending through the two IDB private sector windows rose in line with IDB-9's mandate. The volume of NSG lending through the Structured Corporate Finance (SCF) and Opportunities for the Majority (OMJ) departments, was 25% higher in 2012-2015 than it had been in 2006-2009, with the average size of NSG loans falling by half but the number of loans more than tripling.

Moreover, the IDB has moved very proactively since 2013 to restructure its private sector activities by SCF and OMJ into the Inter-American Investment Corporation (IIC),[13] a separate legal entity. OVE recently completed an in-depth review of progress with the implementation of this "merge-out" from March 2015 through June 2017. The review recognized that implementation of the merge-out is still at a relatively early stage, and it focused on the direction of change – that is, the extent to which the process is helping IDBG in general, and IIC in particular, position itself to enhance development effectiveness and additionality, efficiency and sustainability, and public-private synergies.

The merge-out review found significant progress along multiple fronts, as well as continuing challenges. After a difficult early period, IIC is successfully building a strong human resource base and moving toward a unified culture. On the operational side, IIC is on track to meet its 2017 approval target after a slow start in 2016. As planned, there has been a shift toward larger projects and toward energy and infrastructure and away from financial intermediaries. Lending has been especially strong in a few middle-income countries with particularly good emerging business opportunities. The relevance of design and the additionality of projects appear to be improving, though further progress is needed. Further work is also needed on selectivity tools, simplification of processes, and tracking of operational costs.

Finally, on the financial side, IIC capital contributions are largely on track, and capital is relatively plentiful, though achieving profitability will be a challenge, particularly in the short and medium term, as IIC rapidly scales up lending. Careful financial planning and management of administrative spending will be essential, supported by improved financial and risk management tools. Cross-booking is complex, and potential conflicts of interest between IDB and IIC will need to continue to be managed.

Recognizing the centrifugal forces that can lead separate organizations in different directions, OVE's IDB-9 midterm evaluation stressed the need to ensure that the Bank Group takes full advantage of public-private synergies. It noted that coordination could be managed either at the sector level or at the country level. The model chosen for the private sector reform—the merge-out—envisions coordination primarily at the country level through a single country representative. Coordination at the sector level is more challenging given the separation of sector specialists between organizations. Actions have been taken to promote IDB-IIC collaboration under the new structure, and strong steps will continue to be needed to make it a reality.

D. Tools for strategic guidance

1. Sector strategies and framework documents

The IDB-9 Agreement mandated a series of new strategies for the Bank to help it define and implement actions pursuant to the broad institutional strategy laid out in the Agreement. These included four thematic strategies – Social Policy for Equity and Productivity; Institutions for Growth and Social Welfare; Competitive Regional and Global International Integration; and Environment, Climate Change, Renewable Energy and Food Security — as well as a strategy on private sector development. OVE analyzed these strategies as part of its midterm evaluation in 2012 and concluded that they "did not fulfill the expectations of a strategy document and in practice appear to have little impact."

In 2012, the Board adopted a new regulatory framework for the Bank (which had been under development since 2009).[14] The previous framework included 32 sector policies, 25 sector strategies (8 from the previous general capital increase), and several sector guidelines. The new regulatory framework includes five sector strategies, six cross-sector policies, and the same operational guidelines, and it adds a new product: 20 sector framework documents (SFDs) (Tables 2.3 and 2.4).

SFDs have a different objective than the previous sector policies. They are not normative, nor do they have fiduciary or budgetary implications. They are seen as an opportunity to take stock of what is known to be effective and what needs to be learned in a particular field, with a view to providing guidance to operational staff.[15] Every division in the Vice-Presidency for Sectors and Knowledge (VPS) that prepares operations is supposed to be guided by an SFD. Because knowledge about development effectiveness is continuously evolving and the Bank itself is constantly learning from its own operations, SFDs are supposed to be updated every three years.

Table 2.3. Comparison between the Old and New Regulatory Documents

Documents	Old: GN-2077-15	New: GN-2670-1
Sector strategies	**25 sector strategies:** Documents seek to identify broad Bank priorities and ways to guide the Bank's action, including the allocation of resources toward uses that will have the greatest impact on those priorities.	**5 sector strategies:** Documents are broad expressions of Bank operational and knowledge priorities, organized according to institutional mandates. Strategies define clear priorities for Bank action and establish goals. Although sector strategies do not have specific budget allocations, they are integrated into the Bank's overarching budgetary priorities.
Policies	**32 sector policies:** Documents seek to guide staff regarding (i) objectives to seek in the performance of their functions; (ii) prudent limits that should circumscribe their actions; and (iii) basic criteria to be met in the preparation and execution of projects.	**6 cross-sector policies:** Only policies with a cross-sectoral focus remain in force; one (OP-708 Public Utilities) has been revised.
Sector framework documents	**Did not exist**	**20 sector framework documents:** Documents provide the Board and management with a forum for sector-specific discussion and orientation. SFDs should provide flexible guidance to accommodate the diversity of challenges and institutional contexts faced by the Bank's 26 borrowing member countries, and at the same time should be narrow enough to provide project teams with meaningful guidance and a clear sense of what the Bank seeks to accomplish in a given sector.
Sector guidelines	Technical documents seek to provide methodological guidance for the design and implementation of programs or projects.	**No change**

Source: GN-2077-15 and GN-2670-1.

Table 2.4. The New Regulatory Framework

Sector strategies	Cross-sectoral policies	Sector framework documents
1. OP-1008 Social Policy for Equity and Productivity 2. OP-1009 Institutions for Growth and Social Welfare 3. OP-1010 Strategy to Support Competitive Global and Regional Integration 4. OP-1011 Climate Change Adaptation and Mitigation, and Sustainable and Renewable Energy 5. OP-1012 Sustainable Infrastructure for Competitiveness and Inclusive Growth (not included in IDB-9)	OP-703 Environment and Safeguards Compliance Policy OP-704 Disaster Risk Management Policy OP-710 Involuntary Resettlement OP-761 Gender Equality in Development OP-765 Indigenous Peoples Policy OP-708 Public Utilities (revised)	1. Education and Early Childhood Development 2. Labor 3. Poverty and Social Protection 4. Health and Nutrition 5. Gender and Diversity 6. Water and Sanitation 7. Energy 8. Transport 9. Decentralization 10. Fiscal Management 11. Justice and Citizen Security 12. Housing and Urban Development 13. Innovation, Science and Technology 14. Support to SMEs and Financial Access/Supervision 15. Integration and Trade 16. Agriculture and Natural Resources Management 17. Tourism 18. Climate Change 19. Environment and Biodiversity 20. Food Security

Source: GN-2670-1 and VPS online portal.

As of October 2017, SFDs for all 20 sectors defined in GN-2670-1 had been submitted for discussion to the Board, and some sectors' SFDs had also been updated.[16] OVE carried out a desk review of these SFDs to assess to what extent they identified knowledge gaps, proposed knowledge activities, and provided guidance on the design and implementation of future operations. While all SFDs discuss the current state of knowledge in their sector, OVE's review found that the amount of evidence presented and depth of the discussion vary. Most present only a literature review without specifically identifying knowledge requirements. In some cases, SFDs present only international evidence on programs and policies outside of LAC that might not have external validity. It is important to recognize that the evidence base varies greatly among sectors, with far more studies to draw on in the social sectors. As more evidence accumulates, the quality of SFDs appears to be increasing. All SFDs provide guidance on the design and implementation of future operations, identifying both broad and specific lines of action that the Bank will pursue in each subsector, and a connection between these lines of action and sector objectives.

Both OVE's interviews and the IDB-9 survey indicate that Bank staff actively use SFDs. In interviews staff expressed their appreciation for SFDs' up-to-date and thorough literature reviews, identification of research priorities, and role in guiding the operational dialogue with counterparts by highlighting the Bank's main priorities in the sector. In a survey of IDB operational staff conducted by OVE in October 2017, over 90% of survey respondents were at least somewhat familiar with the relevant SFD for their area of work, a significantly higher number than OVE found in the midterm evaluation to be familiar with the thematic strategy documents mandated in IDB-9. Of these, about two-thirds of respondents indicated that the SFD substantially influenced the design of lending projects, the content of country dialogue, and the design of Technical Cooperation (TCs) and other analytical work, though there was substantial variation across sectors (see background note for details). Overall, the SFDs that were reported to have the highest influence are Labor; Innovation, Science and Technology; Education and Early Childhood Development; and Integration and Trade. OVE found that the depth of analysis has improved over time, and the survey found that more recent SFDs are more influential. Less use was reported by staff of the Vice-Presidency for Countries (VPC), including in the dialogue with country counterparts.

2. The corporate results framework

The IDB-9 Agreement mandated the implementation of a CRF to increase the emphasis on results throughout the Bank. The CRF was to be an integral part of the Bank's efforts to use empirical evidence to manage for development results and to ensure accountability for delivering results. The IDB-9 Agreement stipulated that the CRF be based on the Bank's five institutional priorities, and that it allow shareholders to monitor the Bank's contribution towards selected regional development goals as well as desired progress on outputs and operational effectiveness and efficiency.

OVE's midterm evaluation found that the IDB had made progress in moving toward managing for development results anchored in a CRF, but also found several inconsistencies and gaps in the CRF structure. Some of the deficiencies had to do with a weak alignment between lending and institutional priorities, unclear rationales for indicator selection, lack of realism in targets, inconsistent inclusion of baselines, and unclear attribution of outputs to Bank efforts. OVE also found that the use of results frameworks for decision-making on budget and personnel resources was in many instances weak or nonexistent. The governance of the CRF and related issues of input data quality and other aspects of accountability were also weak. OVE therefore recommended that the Bank revisit the CRF with an eye to simplification, improved data accuracy, and full knowledge and ownership by Bank staff and other stakeholders.

In November 2015, the Board approved a simplified and more robust CRF 2016-2019. The four levels of the original CRF were reduced to three: regional context, country development results, and IDBG performance.[17] The number of indicators was reduced from 84 to 55 (plus 49 auxiliary indicators intended to explore variables that could be included in the main list in the future). Of the 55 indicators, about half are new and half were carried over from the previous CRF. The rationale for the indicators selected was stronger than under the previous CRF, mainly due to increased engagement of sector specialists in defining them—which also helped strengthen ownership.[18] As was mentioned earlier, the thematic lending targets by IDB-9 priority areas were discontinued and greater focus was placed on strategic priorities and cross-cutting issues. Importantly, the CRF now tracks the entire IDBG, including SG and NSG lending, as well as the entire range of instruments – loans, grants, equity investments, and non-reimbursable TCs.

Efforts to monitor achievement of CRF targets have increased, though it is not clear that the CRF yet significantly influences decision-making. The Development Effectiveness Overview (DEO) reports progress against the CRF annually, while quarterly business reviews and the new CRF website do it on a more regular basis. Country strategies and sector framework documents often refer to the CRF's regional context indicators, and the CRF and DEO were used to inform IDB's 2018 strategic outlook paper. Some CRF indicators are also used in staff performance evaluations, partly cascaded down to division chiefs. Despite this increased attention, OVE's interviews indicate that the CRF is not yet seen as having significant influence on decision-making in the organization.

E. Conclusions

The IDB-9 Agreement set out a strategic vision with broad objectives, goals, and sector priorities, and it made a strong effort to ground this vision in top-down mandates. This evaluation finds that the framework influenced IDB's strategic directions in some particular ways, most notably in the major scale-up of grant financing to Haiti. The other noteworthy shift was the reorganization of the Bank's private sector windows, though whether IDB-9 was the primary impetus for this effort is less clear than in the Haiti case.

However, the sector-related strategic mandates do not appear to have changed Bank behavior or results in a significant way. The Bank produced the required strategies, but they do not appear to have had a significant impact on Bank activity and were quickly supplemented by more flexible SFDs. It is also not clear that Bank lending was significantly influenced by the existence of thematic lending targets. The Bank monitored loan approvals in accordance with the targets, but, as OVE noted in the midterm evaluation, their classification schemes were defined so broadly that they could readily be met without major operational shifts. Though shifts in patterns of sector and country lending did occur over time, inertia served to keep these changes gradual.

Though reduction in poverty and inequality was a central pillar of IDB-9, there is little evidence that the Bank focused more directly on these topics than it had before, other than through its heightened engagement in Haiti. Reaching the C&D lending targets was not synonymous with more focus on poverty or more lending to low-income countries, and the FSO's merger with OC kept the level and terms of concessional lending more or less the same as before. The one area that was clearly poverty-focused was the grant-based support to Haiti, though strong and systemic positive results have yet to emerge from that support.

That being said, a broad emphasis on economic growth encompasses much of what the IDB does and is also important to poverty reduction. Providing support in areas that underpin economic growth – such as infrastructure and environment, fiscal policy, governance and institutional strengthening, social services, and financial and private sector development – is a meaningful contribution to IDB-9's overarching goals of economic growth and poverty reduction.

IDB is essentially a demand-driven bank, and one lesson of IDB-9 is that heavily prescriptive mandates do not fit comfortably in such an environment. Efforts to demonstrate the achievement of mandates can distort incentives and behavior and lead to a waste of scarce resources. Going forward, it is critical that the Bank's strategy grow organically from the environment in which the Bank operates. The most important challenge in this environment is for the Bank t*o do whatever it does well*, and that is the subject of the next chapter.

3

A second intermediate outcome sought by IDB-9 was increased client responsiveness and development effectiveness. IDB has made substantial progress in this way strengthening, among others, the depth and coherence of country diagnostic inputs, its lending instruments and its knowledge work.

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3 Client Responsiveness and Development Effectiveness

In addition to strategic selectivity, a second intermediate outcome sought by IDB-9 was increased client responsiveness and development effectiveness:

> The substantial increase in lending…after the realignment of 2007 indicates that demand is highly sensitive to a more responsive and efficient Bank. An expansion in lending would give greater impetus to changes that improve effectiveness in fulfilling the Bank's mission of fostering development in the LAC region, and these changes are also required for the IDB to play a greater role in responding to these demands. The Agenda for a Better Bank…describes the actions necessary to maximize the effectiveness and impact of IDB's interventions.

Many IDB initiatives ongoing at the time of IDB-9 were incorporated into the IDB-9 Agreement under the heading "Agenda for a Better Bank." The agenda covered two main areas: improvements in "what the Bank does," covered in this chapter, and improvements in "how the Bank works," covered in the next chapter.

The IDB-9 mandates touched upon virtually all of the key instruments of Bank-client engagement. ***Country strategies*** were to build on a strong country framework and encompass the full range of Bank instruments. The Bank's ***lending instruments*** were to effectively support development and reflect changing country needs and contexts. The framework to deliver ***knowledge products*** (including fee-based services) was to be strengthened. The ***Development Effectiveness Framework*** (DEF), which pairs a set of tools for learning and accountability for results with an effort to build up evaluation capacity, was seen as the centerpiece to improve what the Bank does. Progress in development effectiveness was to be reported annually through the Development Effectiveness Overview (DEO). Assessments of ***macroeconomic sustainability*** at the country level were to be performed at least once a year as one of the prerequisites for maintaining the Bank's aggregate exposure with the country. The Bank was to continue to expand its focus on environmental and social sustainability and strengthen its ***safeguard system***, including through the application of gender-based safeguards and the operationalization of the

Independent Consultation and Investigation Mechanism (ICIM). It was to build up and use ***country systems*** for greater country ownership and greater effectiveness and efficiency, and to maintain its leadership position on the issue of ***combating fraud and corruption*** by supporting anticorruption and transparency efforts in the region.

A. Country strategies and country programming

The IDB-9 Agreement reiterated the central role of the Country Strategy (CS), the main tool used to define the Bank's program of support to its client, and included two new elements. First, the CS preparation process was to encompass, and to draw on, a broad country development framework. Second, the CS and annual programming processes were to include the Bank's NSG lending to capture the full array of IDB products and country demand.

OVE's IDB-9 midterm evaluation found partial compliance with the IDB-9 country programming commitments. Although CSs provided an analysis of country characteristics, development challenges, and key sectors, it was typically unclear how the analysis served to define priorities for the Bank. CSs also provided little meaningful discussion of the IDB's comparative advantage or of its past successes and failures in proposed areas of intervention. In addition, they did not always build on the full range of the Bank's analytical work and typically paid insufficient attention to non-lending activities—knowledge products and TC. And finally, CSs provided very limited discussion of NSG lending or its role in fostering country development, and of synergies between NSG and SG instruments. In light of these findings, OVE suggested revisiting the CS guidelines.

In 2015 IDB introduced new CS guidelines, which took effect at the start of 2016. The new guidelines preserve the innovation of the 2009-10 guidelines in distinguishing the role of the CS—to set out the "what" rather than the "how" of support, and in a results-focused way—but introduced several significant changes. The main change is the introduction of the Country Development Challenges (CDC), a self-standing document that serves as analytical input to the CS. The CDC is led by the country department, with support from VPS and the private sector windows. The CDC is intended to identify, from the IDBG's perspective, the main development challenges that hinder inclusive and sustainable growth in the country, as well as the interventions that could address those challenges with greater development impact. Rather than providing stand-alone sector notes, VPS now provides sector inputs to the CDC that VPC integrates into a single document.

Two other major changes introduced by the new CS guidelines are the more integrated treatment of cross-cutting themes and the role of the NSG windows in the CS preparation process. The CDC is intended to address three cross-cutting themes that are corporate priorities for the Bank: gender equality and diversity, climate change and environmental sustainability, and institutional capacity and rule of law. While previous guidelines had already emphasized the integration of private sector operations, the 2015 guidelines emphasized participation by staff of IIC and the Multilateral Investment Fund (MIF) staff in CS preparation and monitoring, and links with the IIC business plan.

Looking at early experience,[19] OVE found that CDCs provide integrated diagnostic analyses with a strong focus on factors constraining growth. Such integrative frameworks were previously missing and add significant value. Comparing the process with the isolated production of individual sector notes, most interviewees believe that preparation of the CDC has helped sector specialists see how their area interacts with the broader country development picture at the analytical, not just the operational, level. Some "Country Day" events around CDC preparation, which bring together sector specialists and economists under the leadership of the country representative and regional economic advisor, have been able to nurture cross-sectoral discussions to help develop integrated views of development constraints. The CDCs have also reportedly improved the quality of discussions with country authorities and have helped to identify and address knowledge gaps—although these gaps have not been systematically pursued in CSs and Country Programming Documents (CPDs).

OVE identified three challenges related to CDCs. First, the CDC exercise may have reduced VPS incentives to provide quality inputs (Box 3.1), as such inputs no longer serve as advocacy vehicles for operations nor constitute self-standing knowledge products for which VPS staff can take credit. Second, CDC preparation has been only partly aligned with political cycles, though alignment seems to be improving with the CDCs that are now under way. Finally, the potential of CDCs to serve as knowledge products has remained underexploited. CDCs have *de facto* been treated as little more than in-house inputs to CSs, and little effort has been devoted to packaging and dissemination.

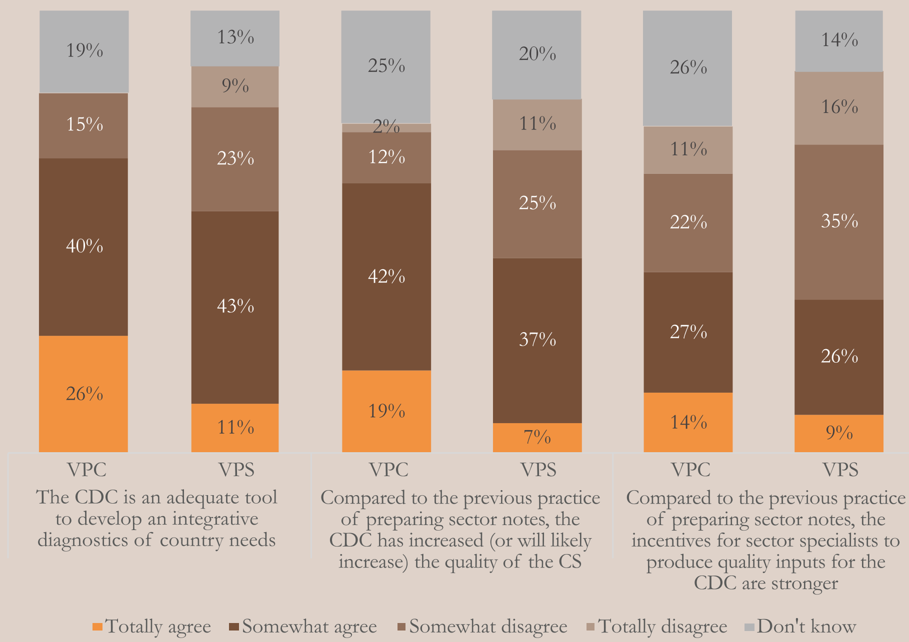
CDCs have not led so far to significant changes in the content or selectivity of CSs. Although there is some variation across CDCs, they have done better at providing a conceptual framework for structuring the analysis than at prioritizing among binding constraints and areas of intervention. Consequently, the range of potential IDB interventions consistent with CDC analysis remains very wide in most cases, and CSs — which also reflect country demand, the IDB's existing portfolio, and other factors — do not appear significantly more focused or selective than before.

Integration of the private sector windows into CS preparation—the second IDB-9 mandate related to country programming—has been notably strengthened. The CDC and CS preparation processes now routinely involve IIC, facilitated by the IIC-IDB coordination division created in IIC after the merge-out. MIF's engagement in the CDC/CS preparation process appears less systematic than IIC's, but nevertheless also stronger than before.

As OVE's midterm evaluation found, the alignment among CSs, annual programming, and actual lending amounts remains partial. Since 2013, CPDs have provided an assessment of the strategic alignment of annually programmed SG operations with their respective CSs. Occasional lapses notwithstanding, in most countries and years there appears to be broad alignment, suggesting that CSs have some measure of enduring value in guiding programming. Indeed, over three-quarters of VPC and VPS staff surveyed by OVE believe that CSs are very influential in defining the Bank's programming in a country. Yet neither CS lending envelopes nor CPD project pipelines have accurately predicted actual approvals since 2011. In the aggregate, actual approvals fell short of CS lending envelopes by 15%, while they exceeded the amounts programmed annually in the CPDs by 11% (with higher deviations being common in some countries). This pattern reflects the indicative nature of CS and CPD financing scenarios and the flexibility of the programing process and is unlikely to change under the new CS guidelines.

Box 3.1. VPS and VPC Opinion on CDCs and CS

OVE's IDB-9 Survey asked VPS and VPC staff their opinions on the changes introduced to the CS under the 2015 guidelines. Overall, VPC seems to have a more positive opinion than VPS. A larger proportion of VPC respondents believe that the CDC is an adequate tool to develop an integrative diagnostic of country needs; that the CDC has increased (or will likely increase) the quality of the CS; and that the incentives for sector specialists to produce quality inputs for the CDC are stronger now.



Source: IDB-9 Survey, OVE, n=281.

B. Operational instruments

1. Lending

The IDB-9 Agreement called for a review of existing instruments and policies to emphasize development results and tailor instruments to specific needs:

> The Bank's operational instruments need to effectively support development purposes and reflect changing country needs and context. Over the last years,

> the Bank has created an array of operational instruments that have focused more on administrative processes than on supporting development outcomes. While the current lending categories of policy-based and investment loans will be maintained, a review of existing instruments will consider simplifying the menu of instruments and updating administrative policies to emphasize development results, and tailoring instruments to specific needs.

This mandate, particularly the need to tailor instruments to country needs, has generally been met. The Bank moved to simplify the instrument set by dropping three investment lending modalities that were seldom used: the Innovation Loan, the Sector Facility, and the Performance-Driven Loan. It has introduced two new modalities in response to country demand: the Loan Based on Results (LBR) and the multisectoral Conditional Credit Line for Investment Projects (CCLIP). The LBR builds on lessons from the Performance-Driven Loan pilot and from other MDBs.[20] In 2016 IDB expanded eligibility for the CCLIP from support for a single agency to support for multiple agencies under a single thematic umbrella. For example, a program to improve child nutrition could support health, education, and agriculture ministries with individual loans under the CCLIP umbrella.

The IDB has experimented with several emergency and conditional nstruments under the IDB-9 Agreement. A Deferred Drawdown Option (DDO) was added to the policy-based lending category in 2012, allowing countries to draw on the resources of policy-based loans (PBLs) if needed. A Contingent Credit Line for Natural Disasters was also approved in 2012 under the category of policy-based support, but is no longer funded. In the emergency category, the Development Sustainability Credit Line was approved in 2012 but expired as a lending category for new approvals in late 2015. In 2017, it was replaced by the Special Development Lending instrument, a category separate from investment lending and policy-based lending in the IDB's lending framework. Special Development Lending is designed to help borrowing countries address macroeconomic crises and can be used only when there is an IMF program in place.

Finally, expanded flexibility in the use of guarantees and the introduction of a Flexible Financing Facility (FFF)—while not lending instruments—have been important innovations during the IDB-9 period. As with other MDBs, the IDB can finance investment loans and PBL directly or back the operations through SG guarantees provided to the ultimate financers. In 2013 greater flexibility was added, allowing for the structuring of IDB partial credit and political risk guarantees, though the annual client survey in 2015 indicated little familiarity with these tools. The FFF became fully operational in 2012 for all SG lending financed by the Bank's OC. Borrowers have a variety of options to tailor the financial conditions of their loans to their needs, including choice of currency (with a local currency option in some cases) and flexibility in repayment schedules. The facility also provides for hedges that allow borrowers to adjust financial terms during the life of a loan. OVE's midterm evaluation found that IDB borrowers view the FFF as an indicator of IDB responsiveness to borrowers' concerns and an effort to make Bank products more attractive in a highly competitive environment.

The Bank needs to take another look at its operational models and staff incentives for results on countries with weak institutions and governance.
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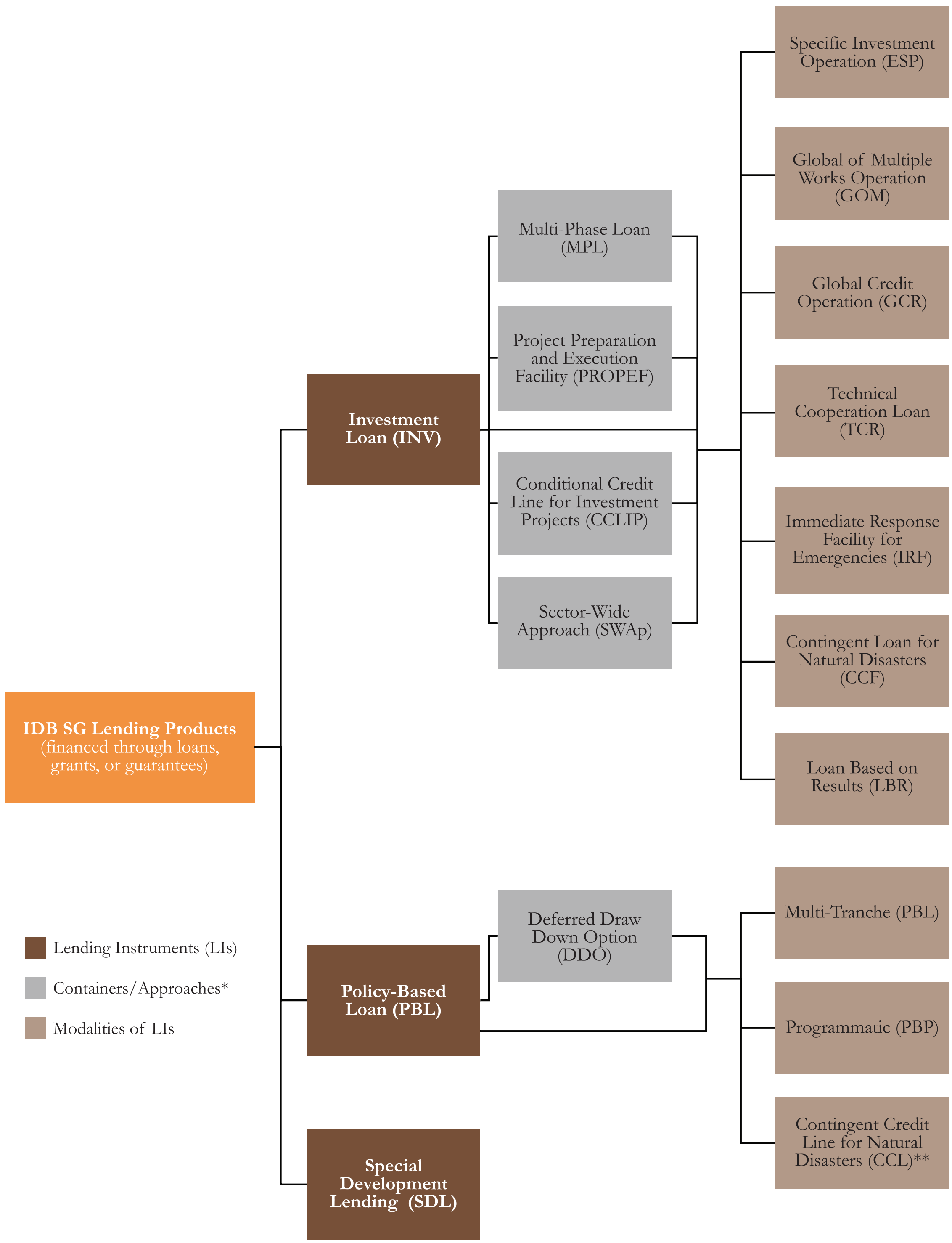
OVE's analysis suggests that there are no obvious gaps in IDB's set of SG lending instruments, and there might even be room for further consolidation on the investment lending side. Currently IDB has seven investment lending modalities (Figure 3.1).[21] Given that only one IDB investment modality – the Specific Investment Operation – is extensively used, and much of the relevant policy and guidance is similar across investment lending types, the Bank might want to consider reducing the number of modalities. A general policy could set out the key requirements for investment lending support (notably around financing a clearly defined project) while allowing flexibility in structuring to meet client needs. An exception is results-based lending, which would continue to require its own policy and procedure.

There is also room for streamlining approval procedures. The IDB has three procedures for Board approval of SG loans: standard procedure, simplified procedure, and short procedure. In addition, the Board may delegate approval authority to management.[22] The share of operations submitted for Board discussion following the standard procedure has risen from less than half before the IDB-9 to close to two-thirds in 2014-2016. In comparison, the World Bank (WB) and Asian Development Bank Boards discuss around 10% and 30% of lending operations, respectively. Two factors contribute to this high rate of discussion by IDB's Board. First, some criteria for Board discussion, including approval amount thresholds, have not been updated in since 1995 (GN-1838), despite increases in average loan sizes.[23] Second, the number of programmatic policy-based loans has risen, and they must follow the standard procedure. Discrepancies in approval procedures across instrument modalities lead to anomalies, such as the fact that some very large CCLIPs (some for US$1 billion each) follow the short approval procedure while non-reimbursable TCs larger than US$10 million are discussed by the Board.

Figure 3.1. Current IDB SG Lending Instruments and Modalities



*Any investment lending modality can be used under MPLs, PROPEF, CCLIPs and SWAPs. The DDO can be applied to both PBLs and PBPs.
**CCLs are treated as PBLs for all operational, fiduciary, and procurement purposes. The CCL is not currently funded.
Source: OVE

2. Knowledge

The IDB-9 Agreement did not go into detail on knowledge and capacity-building products but did call for IDB to "strengthen these products as a component of the Bank's core business and to adapt their funding strategy, operational and accountability arrangements." It also supported the "Fee-based Services (FBS) funding option to tap the unexplored potential for substantial cost recovery."

Producing and sharing knowledge has been a large part of the Bank's work under IDB-9. OVE estimates that IDB spending on knowledge generation has totaled over US$1 billion -- or over US$150 million per year on average -- since 2010.[24] About one-half of this was funded by IDB's administrative budget and about one-half through TCs funded by OC Strategic Development Programs and Trust Funds.

The IDB has also made some progress in advancing fee-based advisory and knowledge services, though demand to date has been modest. In 2013, the Bank adopted a policy on fee-based services,[25] including national and subnational governments, public enterprises, private sector entities, and nonprofit organizations as eligible clients. To date, however, there has been limited demand. TC grants are preferred when available and appear to crowd out much of the potential demand for fee-based services.[26]

The main need in the knowledge area is for prioritization and streamlining. OVE's 2013 midterm evaluation noted the high transaction costs associated with TCs, the absence of a monitoring and evaluation (M&E) system, and the weak links between knowledge and lending. OVE's 2014 evaluation of IDB's Special Programs reaffirmed the need for more strategic TC programming (ideally linked with the annual programming process for lending), more effective knowledge management, and better results measurement. OVE's 2017 review of IDB impact evaluations documented the enormous growth in IDB's production of impact evaluations over the past decade and recommended greater prioritization, attention to quality, and emphasis on client ownership going forward.[27] Though management has taken steps to improve the monitoring and reporting on TCs in response to the 2013 and 2014 evaluations, the recent review of impact evaluations indicates that there is still substantial room for greater prioritization of knowledge work.

C. Development effectiveness

IDB launched its Development Effectiveness Framework (DEF) in 2008, aiming to generate a body of knowledge about what works in meeting the region's development challenges. The DEF consists of three building blocks: (i) the DEM, which includes an *ex-ante* assessment of the project's expected ability to report on results at completion; (ii) the Progress Monitoring Report (PMR), a project monitoring/supervision report tracking implementation progress, and (iii) the Project Completion Report (PCR), a report assessing project results at completion.

The commitment to enhance development effectiveness through measuring the results of Bank operations was reinforced under IDB-9. Projects being submitted for Board approval were to have a DEM that rated project evaluability using standard criteria, and all projects submitted to the Board for approval were to have a minimum evaluability score of 5 (on a scale of 1-10). Once a project was approved, a PMR was to be used regularly "to monitor the outputs and outcomes of the project, and their delivery in terms of both cost and time."[28] At completion, all projects were to have completion reports that measured actual results against the DEM's expected results. The annual DEO was to report on these results, including the evaluability of the portfolio, compliance with institutional priorities, the economic analysis contained in the portfolio, results from project monitoring and impact evaluations, and implementation of OVE recommendations.

The DEM received the most attention during the early part of the IDB-9 period; while the IDB-9 requirements concerning the DEM have been achieved, issues of accuracy and relevance remain. OVE conducted several review and validation exercises during 2011-13 that recommended changes in content and scoring, most of which management has implemented. The rating system of the DEM has now stabilized, and the IDB-9 target for DEM scores has easily been met. The most critical question now surrounding the DEM is whether it remains an accurate measure of project evaluability. In interviews with OVE, staff reported that they had become adept at designing projects with high DEM scores. OVE's validations confirmed, however, that designs at approval may differ markedly from the projects that actually get implemented, as current guidelines allow management to change a project's results matrix throughout its life. This limits the incentive to specify credible results matrices at project approval, and original DEM scores may well lose relevance through the project cycle.

Most IDB-9 requirements for the PMR have also been met, though further refinements are needed. Most importantly, the PMR does not currently monitor outcomes, as it does not require a judgment on whether a project is on track to achieve its development objectives. Rather, attention is on outputs and expenditures, which drive the classification of projects among the three categories of "satisfactory," "alert," or "problem." Many IDB staff interviewed by OVE do not believe this classification system accurately reflects project performance. The guidelines allow reclassification of projects, with justification by the project team leader and approval by the country representative, and the number of such reclassifications has been growing – from just under 10% in the March 2014 cycle to over 12% in the March 2017 cycle. About 90% of the changes in ratings have been upgrades (with that percentage rising each year), with three-quarters of those being upgrades to satisfactory.[29]

The slowest part of the DEF to be implemented has been the PCR, which is still work in progress. IDB's commitments under IDB-9 stipulate that "OVE will validate achieved results in completed projects…[comparing] actual results achieved with the results expected at project approval…" and that IDB will include as an indicator in the CRF "the percent of projects with satisfactory rating on development results at completion." In 2017 OVE produced the first full validation results for the 21 PCRs completed through 2016.[30] Overall, OVE found that significant progress has been made in establishing a credible and consistent objectives-based self-evaluation system. PCRs are generally candid and of good quality, and they distill a range of important lessons that can inform the design of future projects, though there are still challenges to address. Stronger efforts are needed to ensure that PCRs are in line with the objectives-based methodology and are consistently delivered on a timely basis. Management's current practice of allowing indicators and targets to be changed up to the last PMR (or even during the PCR exercise) is too flexible and compromises its ability to assess how effectively an operation has indeed performed. Further clarity is also needed on what type of economic analysis to carry out to assess efficiency for various types of operations. The Board endorsed OVE's recommendations, and management and OVE are currently following up.

The IDB-9 Agreement had very specific requirements regarding the DEO. Compliance with these requirements has increased over time, though gaps remain in at least four areas: (i) candidly addressing issues surrounding the quality of information on project results, (ii) acknowledging and using validated PCR results, (iii) discussing issues arising from the full range of impact evaluations, and (iv) reporting systematically on the implementation of OVE recommendations. The DEO has increasingly focused on reporting IDB's progress in achieving CRF indicators but further improvements are required to enhance its role as an accountability tool as intended by IDB-9.

D. Safeguards and policy compliance

IDB has two types of safeguards to ensure that its projects minimize and mitigate any harm caused by its lending, the first to keep the IDB from lending into unsustainable macroeconomic conditions and the second to minimize or mitigate potential environmental and social harm. IDB-9 included specific mandates on the scope and content of macroeconomic safeguards and a more general requirement that the Bank implement the recommendations of a prior commission regarding environmental and social safeguards (including gender). It also called on the Bank to fully implement the policy, approved by the IDB Board in early 2010, to establish an Independent Consultation and Investigation Mechanism (ICIM) to serve as an external check on compliance with its policies. The specific mandates on macroeconomic safeguards and the ICIM are discussed below. [31]

1. Macroeconomic sustainability

IDB-9 took a major step in extending macroeconomic safeguards to the entire lending envelope. The Bank implemented macroeconomic safeguards for the first time with the introduction of PBLs in the late 1980s, relying heavily on IMF analysis in the early years and then creating an in-house analytic product, the Independent Macroeconomic Assessment (IMA), in 2005. IDB-9 introduced a new instrument, the Macroeconomic Sustainability Assessment (MSA), the content of which the IDB-9 Agreement mandated in great detail.

OVE's midterm evaluation concluded that the MSA safeguard had "been substantially implemented but face[d] many difficulties that seriously impede its likely effectiveness." Subsequently, Governors reformed the instrument, replacing IMAs and MSAs with a single Independent Assessment of Macroeconomic Conditions (IAMCs). They asked OVE to review the IAMCs two years after their introduction, and an evaluation was completed in early 2017.[32]

In this recent evaluation OVE found that the macroeconomic safeguard reform mandated by the Governors in 2014 had been fully implemented. As of end-2016 over 80 IAMCs had been produced for all but two borrowing member countries. The introduction of the IAMC had led to substantial improvements in the operation of the macroeconomic safeguard, leading to greater consensus on the mandate and strengthened IDB in-house capacity to produce macroeconomic analyses. The average quality of IAMCs was significantly better than that of the MSAs, though quality continued to be heterogeneous.

IAMCs are produced by VPC and reviewed by the Research Department, and OVE found the process to be relatively informal, with limited institutional accountability regarding the final decision. Management agreed with OVE's recommendations: reduce periodicity and streamline updating procedures for IAMCs, update technical guidelines, strengthen the role and accountability of the advisory committee (Macroeconomic Working Group) in supporting decision making (rather than leaving it solely to the Chief Economist), decrease the level of IAMC confidentiality, and improve communication with client countries, including ensuring that a draft IAMC—including the rationale for issuing or not issuing the document—is always available to share with national authorities.

2. The Independent Consultation and Investigation Mechanism

In line with the IDB-9 mandate, the ICIM became effective in September 2010 and began to handle complaints from persons affected by Bank projects. In 2012 OVE conducted an evaluation of the first two years of ICIM operation and reported the results in its midterm evaluation of IDB-9. ICIM's structure was found to be dysfunctional, undermining its accountability for delivering results with integrity and efficiency. Moreover, the policy reflected ambivalence about the extent to which the Bank wanted to receive complaints. OVE recommended that the Board end ICIM's two-year pilot phase and establish a new accountability mechanism with well-defined functions and accountability.

In follow-up to the midterm evaluation, the Board conducted extensive consultations and in December 2014 approved a new policy (MI-47-6). It corrects most of the weaknesses that OVE identified in the 2010 policy. It gives the ICIM an internal structure and reporting arrangements that provide clear accountabilities and avoid conflicts of interest, and it requires that ICIM handle complaints transparently and promptly and that IDB Management respond systematically to ICIM findings. Like the earlier policy, however, it lacks a full and clear vision statement of what the mechanism is expected to achieve.

The ICIM is functioning much better under the 2014 policy. It has registered about 25 complaints since the policy was adopted, most from individuals or communities who claim their land or livelihoods may be affected by Bank-financed projects. Five of these complaints have been found eligible for ICIM involvement – three for compliance review and the other two for consultation (dispute resolution). In addition, the ICIM has concluded several cases that had been started under the 2010 policy. All findings, along with IDB Management's responses, are posted on its public website. Staff consider that ICIM's presence is helping to focus their attention and that of IDB's clients on policy implementation, especially on communicating constructively with project-affected communities.[33] Though this early experience is positive, more experience will be needed for broad lessons to emerge.

E. Support to institutional strengthening and governance

The importance of institutions and governance, and the need for IDB to help strengthen them, are themes that run through the IDB-9 agreement. In addition to requiring a strategy in this area, as discussed in the previous chapter, IDB-9 included two specific operational mandates – to support the strengthening of national systems and to help countries with anticorruption efforts

1. National systems

IDB-9 committed the Bank to support the strengthening of national systems and to increase their use in Bank-financed operations, in accordance with the strategy approved by IDB in 2010.[34] Though the strategy recognized that all national systems were important for development effectiveness, it gave greater priority to financial management, procurement, planning, and M&E than to environmental and social safeguards and statistics. The strategy sought to balance fiduciary risk and long-term capacity building, and it recognized that progress must be gradual, country-driven, and tailored to country conditions. It envisaged three types of IDB activities: (i) diagnosis of the national system (and relevant subsystems); (ii) validation, and in some cases authorization, of the use of the system in Bank projects; and (iii) support for capacity-building.

OVE's midterm evaluation in 2012 found the strategy to be sound and to effectively address the main factors that have constrained the use of country systems in the past.

It also found substantive progress in meeting the strategy's targets, particularly for fiduciary systems. Following OVE's review, the Bank presented a three-year review of the country systems strategy (GN-2538-9) in 2013, and the Board approved a follow-up strategy (GN-2538-14) in 2014. Under this strategy, the Bank committed to 19 new expected results to be met by 2018, to be supported through a Special Program for Institutional Development.

OVE finds that further progress has been made in both fiduciary and development effectiveness systems since 2013. Of the 19 expected results, seven (37%) have been met or exceeded, progress has been made toward nine (47%), and little or no progress is evident in three (16%). The initial fear of reversal of certification has not materialized, and initial coordination challenges among the IDB units responsible for implementation (ICS – Institutional Capacity of the State, FMM – Fiscal and Municipal Management, and FMP – Financial Management and Procurement Services) have been solved. The number of Bank employees and the time spent by executing agencies supervising procurement processes have reportedly fallen by around 10% and 25%, respectively. Using supreme audit institutions costs about one-third of the cost of hiring external auditors. Most importantly, the agenda can help to strengthen local institutions and increase their ability to comply with international standards, thereby enhancing governance and improving the business environment.

However, it is also clear that progress has been slower during 2013-2017 than it was during 2010-2013, as the more difficult challenges remain. Continued support and a strategic use of instruments will be necessary to continue to achieve results, particularly in more difficult settings. The strategy, currently being updated, commits the Bank to work in all 26 member countries. Given the complexity of country systems (including the many subsystems associated with each system), the varying absorptive capacity of member countries, and the long-term nature of the associated reforms, making progress in all member countries will require a concerted IDB effort for years to come. Concerns about funding or government commitment will need to be considered as part of CS preparation, and some prioritization of effort on the part of the Bank is likely to be needed. Ensuring that the Bank's work is aligned with the UN Sustainable Development Goals (of which goal 16 is relevant to this effort) can help to mobilize resources and create unity of purpose in this area.

2. Supporting countries on anticorruption and governance

The IDB-9 Agreement committed the Bank to strengthen its activities related to fraud and corruption along three strategic pillars: (i) protecting Bank-financed activities from fraud and corruption; (ii) supporting member countries in strengthening good governance and combatting corruption; and (iii) ensuring the highest level of staff integrity. The second pillar concerns support to client countries and is discussed in this chapter, while the first and third are more internal in nature and are covered in the following chapter.

The Bank's assistance in member countries on anticorruption and governance has grown substantially, albeit episodically, over the IDB-9 period.[35] The Bank's core anticorruption work has been carried out mainly through two divisions in the Bank: Fiscal and Municipal Management (FMM), which has emphasized basic improvements in core public financial management (PFM) capacity, and Institutional Capacity of the State (ICS), which has worked on open and transparent government and control and oversight systems. FMM and ICS assistance has had a strong technology orientation, both in supporting PFM and transparent government and in helping develop e-government services and digital oversight functions. The more traditional PFM support has helped client governments install the systems they need for accountable and transparent government. The ICS approach emphasizes four interrelated areas of probity reforms where openness could make a crucial difference: (i) open government, (ii) transparent access to information, (iii) accountability and audit, and (iv) anti-money-laundering. The Bank's CSs have tended to address governance primarily through the lens of PFM reforms. The Bank has had some difficulty integrating transparency and accountability into broader country strategic priorities or scaling up interventions to achieve greater impact

Systemic corruption thrives where institutions are weak, and the Bank's broader support for institutional strengthening – including through its sector investment projects, its reviews of country systems, and its work on safeguards and procurement – is also critical in improving accountability and reducing corruption. A full review of all Bank activities in support of institutional development is beyond the scope of this review. Yet IDB has had difficulty supporting institutional strengthening or achieving good project outcomes in countries with weak governance and institutional capacity, as documented in many Country Program Evaluations.[36] These are very challenging settings, and it is not easy for the Bank or any other organization to operate effectively in them. A renewed look at IDB project designs and at staff incentives to deliver results in these settings is warranted. Particularly in light of the region's recent corruption scandals, it may be a good moment to revisit the Bank's approach and the logic that has driven operational interventions under IDB-9.

F. Conclusions

IDB has made substantial progress in implementing the IDB-9 mandates related to client responsiveness and development effectiveness, albeit with varying degrees of speed and effectiveness. The CS process was revised in 2015 to strengthen the depth and coherence of country diagnostic inputs. This analytic work is proceeding well, though the strategies themselves remain relatively broad. The Bank has revised its lending instruments and now has a broad menu that provides ample flexibility for clients. Knowledge work has grown rapidly, funded by both the Bank administrative budget and OC-funded TCs, and the Bank has made some initial progress in developing fee-for-service options. Substantial progress has also been made in developing instruments to track project results through the DEF, though the components of the DEF – the DEM, PMR, PCR, and DEO – still need strengthening to reach the results intended. Reforms of macroeconomic safeguards and of the ICIM started out badly under IDB-9 but have been turned around with proactive Board and management initiatives in response to OVE's recommendations in the midterm review. Progress has also been made in supporting the development of client countries' fiduciary, M&E, and statistical systems, and in helping countries improve public financial management and increase transparency.

The challenge ahead is to consolidate the gains that have been made under IDB-9 and ensure that they are sustainable. These initiatives are generating costs as well as benefits for the Bank and its clients (as discussed in the next chapter), and strong hands-on management will be needed to preserve critical processes while phasing out lower-priority activities. Building on the experience to date, there is potential to exploit the potential of country diagnostic work as a public good, consolidate investment lending modalities, revisit SG loan approval procedures, streamline the IAMC process, and be more selective in undertaking impact evaluations and other knowledge work. There is also a critical need to complete the implementation of the DEF by revisiting the content of the PMR and the DEO, finalizing the PCR guidelines, and implementing realistic yet enforceable time limits to ensure timely, accurate, and efficient results reporting for all projects. Management is already taking concrete steps in some of these directions.

More fundamentally, the Bank needs to take another look at its operational models and staff incentives for results in countries with weak institutions and governance. No matter how well designed, the tools discussed in this chapter will contribute to IDB effectiveness only if the incentives structures at all levels of the Bank are geared toward the achievement of development results.

4

IDB has made progress in implementing the IDB-9 mandates related to efficiency, accountability, and transparency. The Banks´s processes and systems for RBB, IT, anticorruption in Bank projects, and Bank´s staff integrity have been strengthened.
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4 Efficiency, Accountability, and Transparency

A third intermediate outcome sought by IDB-9 was better efficiency, accountability, and transparency:

> … not only proposals to increase the financial capacity of the IDB, but also a new Institutional Strategy and an agenda to improve efficiency, transparency and governance at the Bank…. The proposed aim of a capital increase is not only to make the Bank bigger, but, above all, to make it better. The Results Framework (RF) and the Agenda for a Better Bank raise accountability to unprecedented levels and should put the IDB in the lead of multilateral institutions in this dimension (para 1.8).

The mandates related to these goals were laid out in the second part of the Agenda for a Better Bank: "how the Bank works" and addressed two objectives: (i) optimizing financial and human resources, and (ii) ensuring that IDB rules and practices are consistent with the highest standards of accountability, prudency, and integrity. With regard to the first, the Bank was to transition to a comprehensive ***results-based budgeting*** (RBB) strategy and methodology, implement "***Program Optima***" to provide integrated IT support, and achieve specific targets for ***gender diversity*** and ***decentralization*** in the Bank. With regard to the second, it was to implement a new ***information disclosure*** policy with a presumption in favor of disclosure, strengthen its capacity to ensure that Bank-financed activities are free of ***fraud and corruption,*** and strengthen ***integrity standards*** for Bank staff.

A. Optimizing financial and human resources

1. Results-based budgeting

The IDB-9 Agreement included very specific mandates on how results-based budgeting (RBB) was to be designed and introduced in IDB:

> The Bank will transition to a comprehensive Results-Based Budgeting (RBB) strategy and methodology that: (a) assigns resources to achieve

> the key performance targets of the RF; (b) measures costs of achieving these results; (c) adapts budget classifications to link resources and outcomes clearly; (d) adjusts budget procedures to ensure that results are considered in a timely manner in the decision-making process; (e) assigns institutional responsibility for resource usage and the delivery of results; (f) modifies Bank information systems to capture and monitor results-based budget allocation and execution; and (g) reports to the Board regularly on results achieved, resources utilized and the percent distribution of the administrative budget between Bank operational and support programs. In this process, Management will draw from international best practices in RBB implementation.

Since 2011 management has developed and implemented two consecutive multiyear RBB action plans. The mandated RBB actions and the implementation of related information systems have to a large extent been completed. This includes the development of a consistent framework for accounting of spending by main business functions (MBFs) and monitoring RBB performance indicators at all levels of the organization. These actions have put in place a tool that can be used to better measure and monitor resource use and the achievement of intended outputs and results. The effort has increased the availability and consistency of data and facilitated the alignment of resources with MBFs across the organization and the cascading down of related results measures.

Significant implementation gaps remain in three main areas: (i) linking resources and strategic objectives (not only MBFs) more directly in business plans; (ii) undertaking analysis at the top to drive budget allocation changes and to capture trade-offs at lower levels; and (iii) fostering efficiency and effectiveness systematically across the Bank. While improvements within the system are still possible (as detailed in a background note to this report), many constraints to greater impact lie outside RBB implementation.

Most importantly, RBB should be further strengthened to guide strategic budget reallocations and decision-making at the corporate level. Corporate budget decisions remain largely incremental, and the link between the RBB and individual performance results remains tenuous. These challenges mirror what many other public organizations have experienced. In many government agencies, budget decisions are said to be driven ultimately more by politics and mandates for budget cuts than by results. RBB is a useful tool but provides only one component to inform more transparent and accountable decision-making.

2. Program Optima

Program Optima was the most ambitious efficiency-related initiative undertaken during the IDB-9 period. It was a critical program for the Bank, as most systems, both operational and corporate, had become obsolete and unable to address the Bank's business needs. It began as an initiative to consolidate all operational systems under one platform and evolved rapidly into a Bankwide program to optimize and digitalize all operational processes and some corporate processes under one single Enterprise Resource Planning solution. By 2010 the capital budget assigned to the program had increased from the original US$37 million (in 2007) to US$55.5 million as the program increased in scope and complexity. The program then suffered several setbacks including four changes in internal management and the use of four different consulting firms. Capital costs reached US$94.5 million by its completion at the end of 2016. Total costs, including personnel, were significantly higher – estimated by OVE US$121 million through 2016 (Figure 4.1).[37]

Program Optima has delivered two major outputs: a SAP system for corporate management and Convergence for operational management. The transition was difficult, but the systems are functioning, and improvements and fixes continue to be made. Business processes were reviewed and standardized prior to IT implementation, though most business processes implemented in Convergence do not differ markedly from the previous ones. Several IT modules were delayed and are still in the Bank's IT pipeline. The work is still ongoing and staff are still getting used to the new systems, which might help to explain why most staff responding to OVE's IDB-9 survey reported that the introduction of SAP and Convergence has not made their work easier.

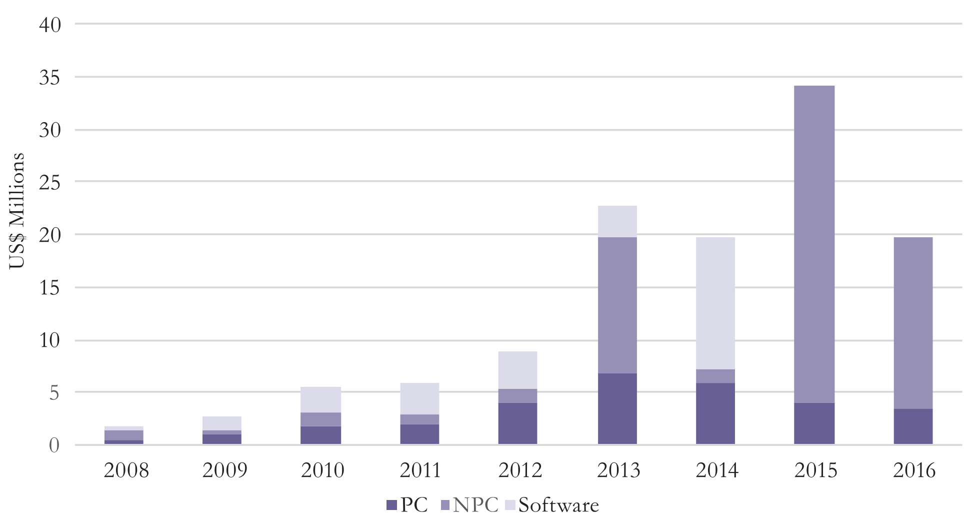

Figure 4.1.

Spending on Optima

Source: Budget data, Enterprise Data Warehouse.

3. Human resources

Given that IDB-9 followed the Bank's 2007-2008 "Realignment," which had already led to major changes in IDB staffing and management, the IDB-9 Agreement included references to ongoing initiatives but did not add many specific HR-related mandates:

The Bank has undertaken many human resources initiatives during IDB-9. The most notable progress was in increasing the percentage of female professionals and executive staff at grade 4 and above, which raised up from 28% to 37%.

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A number of new and on-going initiatives to attract, retain and reward talent will ensure continued capacity to respond to client demands. These actions include a results-based performance framework for staff, aligning talent to business priorities, a reform to the process to contract consultants, continued capacity building in country offices, and continued promotion of diversity in the Bank's human resources—including a Gender and Minority Equality Framework to accomplish a better representation of women and minority groups across professional and leadership levels. Meritocracy and transparency will be the guiding principles in filling all Bank positions.

The Bank has undertaken many HR initiatives during IDB-9, though some IDB-9 mandates have not been met. The IDB-9 Results Framework included four HR-related performance indicators, three related to gender and one to decentralization (Table 4.1). None of these targets was met by the target date of 2015, though important progress was made. The most notable progress was in increasing the percentage of female professionals and executive staff at grade 4 and above, which reached 37% (3% below the target) by 2015 and has risen slightly since. The percentage of females in executive and Vice-President (VP) positions also rose but did not meet the 2015 target of 38%.[38] The percentage of professional staff based in country offices increased from 26% in 2010 to 32% in 2015, significantly below the target of 40%.

The HR indicators and targets were changed with the adoption of the new IDBG CRF for 2016-2019. The gender indicators were consolidated into one -- "mid- and senior-level IDBG staff who are women" -- and extended to the entire IDBG, with a target of 43%

by 2019. The indicator on decentralization was dropped, as the Board and management had concluded that there was not a compelling case for further decentralization.[39]

Table 4.1. Human resource targets in IDB-9 (in %)

Outcomes	Outcome indicators	Baseline	CRF1 target	Actual 2015*	CRF2 target	Actual 2016
Promote gender equality and diversity	Percentage of female professionals and executive staff grade 4 or above	28	40	37		
	Percentage of females in executive and representative positions	18	38	31		
	Percentage of female VPs / EVP	0	40-60	25		
	Mid- and senior-level IDBG staff who are women				43	38
Continue strengthening capacity building in country offices	Percentage of professional staff based in country offices	26	40	32	NA	NA

*Development Effectiveness Overview (2015).
Source: OVE, based on SPD (Office of Strategic Planning and Development Effectiveness) data.

B. Accountability and transparency

1. Information disclosure

The IDB-9 Agreement committed the Bank to adopt a new and more expansive information disclosure policy, in line with those of peer organizations. To meet this commitment, in 2010 the Bank introduced an Access to Information (ATI) Policy that reiterated the prior policy's "presumption of disclosure" principle and introduced several major reforms to better put that principle into practice. Several categories of documents were disclosed for the first time, some simultaneously with their distribution to the Bank's Board. Only documents that contained information meeting a "clear and narrow" list of exceptions to disclosure were expected to be kept confidential (and only disclosed over time).

OVE's midterm evaluation found that adoption and initial implementation of the new ATI Policy was a significant step forward in promoting increased Bank transparency, but significant challenges still remained. The evaluation highlighted progress in creating a policy framework of classification and disclosure guidelines, initiating staff training, setting out a communication plan to increase awareness of the new policy inside and outside the Bank, and establishing a governance structure. While the policy generally met IDB-9 requirements and was broadly similar to those of other MDBs, it lacked clarity and consistency on some key points. In particular, one of the policy's disclosure exceptions—for "country-specific information"—was not found in comparable form in peer institutions. In addition, OVE found that the Bank needed to strengthen IT systems, improve online access, expand staff training, and develop indicators to measure effectiveness.

The Bank has done much to strengthen policy implementation in the last five years. The ATI guidelines have been revised, a new system for processing information requests from the public has been developed, and the ATI website has been revamped. There has also been extensive staff training and support, as well as efforts to increase policy awareness externally.

The policy framework has not been changed, however, and information shortfalls persist. The Bank tracks various indicators of policy implementation, but none of them measures the accuracy and the timeliness of the disclosure of Bank information or how well the policy is working to enhance Bank transparency. There is a lack of readily available information on the frequency of use of all but the country-specific exception to disclosure, and it is not clear to what extent the exceptions may be affecting how documents are written and shared. Finally, the introduction of new IT systems has created significant challenges for the disclosure of Bank information.

Overall, some progress has been made to lead the push toward greater transparency, however further work is needed. While there is a unit in SEC (Secretariat) that coordinates implementation, it does not yet have the seniority to provide strong leadership. As currently set up, the Access to Information Committee is more reactive than proactive. High-level commitment and advocacy will be required if the Bank is to continue on the path to greater transparency.

2. Preventing corruption in Bank projects and encouraging staff integrity

As the previous chapter explained, the IDB-9 Agreement committed the Bank to strengthen its activities related to fraud and corruption along three strategic pillars. Two involve the Bank's staff and internal control systems and are thus discussed in this chapter.

OVE's midterm evaluation noted that the Bank's capacity to address issues of fraud and corruption within its own operations appeared to have improved during the IDB-9 period with the strengthening of the Office of Institutional Integrity (OII). The Office, which was set up in 2004 and given greater independence in 2010, has made a concerted effort to become a more efficient and strategic organization. OII has continued to consolidate earlier reforms that clarified sanctions procedures, streamlined investigative functions and methods, and placed more emphasis on prevention.

However, whether OII has sufficient resources (both human and budgetary) to carry out its important remit remains an open question. The region's overall demand for its own governments to be clean must be matched, if not exceeded, by the Bank's vigilance over its own reputational probity. The Bank should continue to review OII's and associated units' budgetary and staffing requirements, enhance the Bank's and executing agencies' ability to collect and retrieve data on procurement and other areas susceptible to prohibited practices, and continue to forge closer links between OII and operations.

The Office of Ethics (ETH) has also expanded its role and increased its efficiency during the IDB-9 period. The unit engaged in a greater number of consultations and has been active in providing training to IDB staff, consultants, and other relevant audiences. The Bank should continue to review and update its ethics code and ensure that ETH is adequately staffed to take on the mounting challenges of training and outreach on the range of ethics issues that are likely to surface in the years ahead.

C. Conclusions

As with the mandates discussed in Chapters II and III, IDB has made progress in implementing the IDB-9 mandates related to efficiency, accountability, and transparency. The Bank's processes and systems for RBB, IT, anticorruption in Bank projects, and Bank staff integrity have been strengthened, though continued work will be needed to expand their reach and effectiveness. The Optima Program led to a replacement of many of the Bank's operational systems, though at a much higher cost than originally expected and with many remaining challenges. None of the specific HR targets in the IDB-9 CRF have been met, though there has been substantial progress toward them.

The Bank has made meaningful improvements but there is still room to enhance its efficiency and accountability. The Bank has become a larger and more complex organization since 2010 – with increasing annual budgets and more staff and consultants doing more things.[40] Since then, the steps taken have been relevant in laying the groundwork for improved efficiency and accountability through the development of processes and systems, but strong leadership and incentives throughout the organization are necessary to make them more effective in achieving value-for-money and changes in staff incentives. The Bank will also need to improve how it measures efficiency, including among other things, introducing efficiency indicators in business plans and adopting more adept methodologies (e.g., frontier methods).

It is also difficult to judge how much more transparent the Bank has become, given the absence of metrics related to disclosure. The Bank is clearly disclosing more information under the new ATI policy than it did before IDB-9.[41] However, the policy still provides significant exceptions that limit disclosure, and it is unclear to what extent these exceptions limit disclosure of important information or influence the way documents are prepared. Strengthening transparency is a continuing challenge, as short-term interests pushing for greater confidentiality can often muffle the longer-term values associated with disclosure. IDB's reputation is already strong, and its credibility will only improve with more openness and transparency.

5

The bigger challenge, related to but going beyond financial concerns, is competitiveness. As capital constraints have become less of a concern for IDB, demand may emerge as the main limit to increased lending. As LAC countries grow and develop, they are increasingly able to access financial markets at lower costs than borrowing from the Bank.
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5 Financial Sustainability

The fourth intermediate outcome of IDB-9 was financial sustainability. It sought to increase the resources available to IDB sto support development in LAC, but it also imposed strong requirements to manage those resources prudently to preserve IDB's longer-term sustainability and competitiveness:

> Increased financial capacity is a necessary condition for the IDB to support the continued social and economic development of the LAC region…the IMM [includes] a capital accumulation rule that preserves the financial soundness of the bank.

The IDB-9 Agreement called for an ***increase of US$70 billion in the Bank's capital***, with US$1.7 billion to be paid in through annual subscriptions over five years (2011-2015) and the rest callable. At the conclusion of IDB-9, the relative voting power among member country groupings (LAC, US, Canada, and non-regional) was to remain unchanged. The Agreement required the adoption of an ***Income Management Model*** (IMM) to allocate income to meet a number of criteria. The Bank was to continue to upgrade the risk management framework and implement its new ***Capital Adequacy Policy*** (CAP) to maintain the Bank's AAA credit rating while being able to sustain lending during downturns.

The mandated capital contributions were fully paid, though with a delay of one year. While the paid-in capital was roughly equivalent (in present value terms) to the US$2 billion in mandated grants to Haiti,[42] the additional callable capital (US$68.3 billion) was important as it allowed IDB to borrow and ultimately lend more to LAC clients more generally.[43] The increased callable capital also strengthened IDB's AAA rating, but its importance for ratings agencies – and thus also for IDB – has been declining since then. The ratings agencies have made major changes to their MDB ratings methodology since 2012 that have required significant changes to IDB's Capital CAP and IMM, as discussed below. S&P is currently considering another change in its ratings methodology, which would take into consideration much more of IDB's callable capital and bring back some of its relevance for IDB's financial sustainability.

A. The income management model

The Cancun Declaration (later mirrored in the IDB-9 Agreement) introduced the idea of the IMM. It was to "incorporate the new capital adequacy policy, lending program, loan charges, technical assistance grants, and commitments on transfers in a way that will set the Bank on a firm financial footing, preserve its AAA rating, rationalize the allocation of resources through a comprehensive and simultaneous approach, and allow capital to grow over time through the retention of income." The IDB-9 Agreement laid out very specific requirements for the IMM:

> The Bank's income management model allocates income according to the following criteria: (i) minimum annual transfers of US$200 million to the grant facility for Haiti; (ii) a capital accumulation rule that preserves the financial soundness of the bank: (iii) loan charges set as to cover administrative expenses,[44] consistent with the Bank's multiyear budget; (iv) parameters of the Capital Adequacy Policy; (v) FSO administrative expenses fixed at three percent; (vi) non-reimbursable TC fully funded by OC; and (vii) pricing and expenses will be adjusted to meet these constraints.

IDB moved quickly to implement the IMM in 2010, guided by the detailed prescriptive requirements in IDB-9. A concept document was prepared in February 2010 and a completed version in May 2010.[45] The IMM requires management to prepare a document each year for consideration by the Board of Executive Directors proposing the parameters for the following year, based on medium-term financial projections. While the administrative expense rule appeared constraining at the time it was enacted, it has in fact not been binding since the early part of the IDB-9 period.

B. The capital adequacy policy

IDB also implemented the new Capital Adequacy Policy (CAP) and associated regulations, as called for in the IDB-9 Agreement. In 2010, the Board of Directors approved IDB's CAP and associated regulations (FN-568-8). IDB's Governors subsequently endorsed the CAP and regulations and confirmed IDB's target credit rating as AAA. OVE's midterm evaluation in 2012 found that the CAP supported prudent risk management. This was important at the time, since IDB was considering a significant increase in NSG operations, and the new risk-based framework was particularly appropriate for that purpose. For NSG operations, the CAP moved away from a limit on exposure (10% of the portfolio) to limiting the capital requirements to 20% of IDB's equity, as provided in the IDB-9 Agreement. The 2010 CAP was based primarily on a "capital utilization ratio."

In 2012 S&P changed its rating methodology for multilateral lending institutions. The main changes were the introduction of a stand-alone credit profile (SACP) in addition to the issuer credit rating (ICR) and the introduction of a framework based on risk-adjusted capital (RAC) to measure capital adequacy. While IDB maintained its AAA rating for the ICR, because of the "extraordinary shareholder support" in the form of its callable capital,[46] its SACP was initially assessed only as AA and improved to AA+ in the second year. With IDB's funding and liquidity[47] being assessed as "strong", IDB would have needed a SACP RAC ratio over 23% to raise its financial profile to "extremely strong" and to obtain an SACP rating of AAA. Instead IDB's financial profile was assessed as "very strong," with its RAC in the range between 15% and 23%.

In 2014 IDB changed its CAP to explicitly take this change into account. After significant preparatory work, IDB adopted a new CAP Mandate (AB-2994) and accompanying regulations (AB-2996). The CAP Mandate clarified that the AAA rating was a means to fulfilling IDB's mandate (rather than an end in itself), that it served to reinforce prudent financial management, and that it applied to the ICR rating. The CAP Mandate also specified that IDB should maintain the AAA rating under reasonable stress and established zones that were derived from the AAA rating goal. IDB's RAC ratio became the binding factor, and zones (hazard, warning, and buffer) were established around it. The CAP regulations included other changes as well.[48] IDB subsequently amended the IMM (AB-3044 and FN-699-1) and revised the capital accumulation rule to reflect the new CAP. The IMM refers specifically to the CAP and specifies increasingly rigorous steps to be taken if IDB's capitalization drops below full capital buffers. However, once the buffers are full, the IMM provides little guidance on how to manage tradeoffs – for example between lending rates, transfers and future growth.

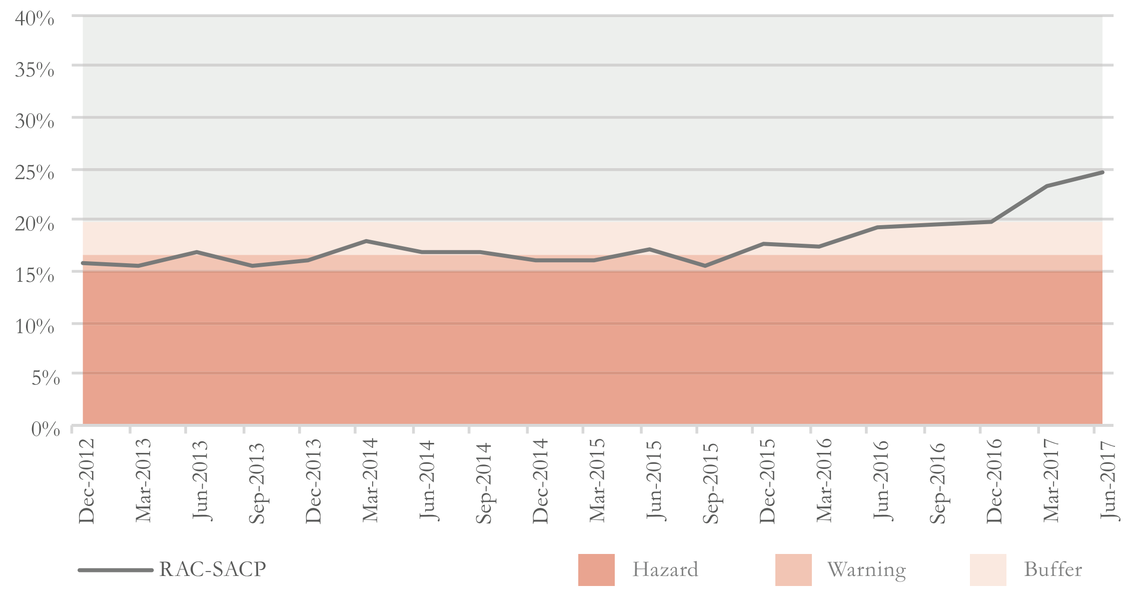
C. Trends in capital adequacy during IDB-9

IDB's credit rating was threatened in 2015, and the new IMM framework facilitated a quick IDB response. Economic downturns in a number of LAC countries during 2012-15 had led to ratings downgrades of some important IDB borrowers, resulting in an IDB RAC ratio close to the hazard zone (Figures 5.1 and 5.2). Governors approved the new IMM in October 2015, and IDB immediately adopted – retroactively to July 2015 – a significant increase in lending spreads (from 85 to 115 basis points [bps]) and commitment fees (from 25 to 50 bps).

A number of other proactive steps by IDB, payments under the capital increase, and external developments further helped to significantly improve IDB's capital adequacy. From the low point in September 2015, IDB's capital adequacy recovered quickly and significantly. The major factors, in addition to the increase in spreads and fees, included the approval of Exposure Exchange Agreements with other MDBs, the last tranche of IDB-9 capital payments, the temporary delay in transfers to Haiti, a ratings upgrade for Argentina (a major Bank borrower), decreases in lending to some other borrowers, and administrative budget reductions in 2015.

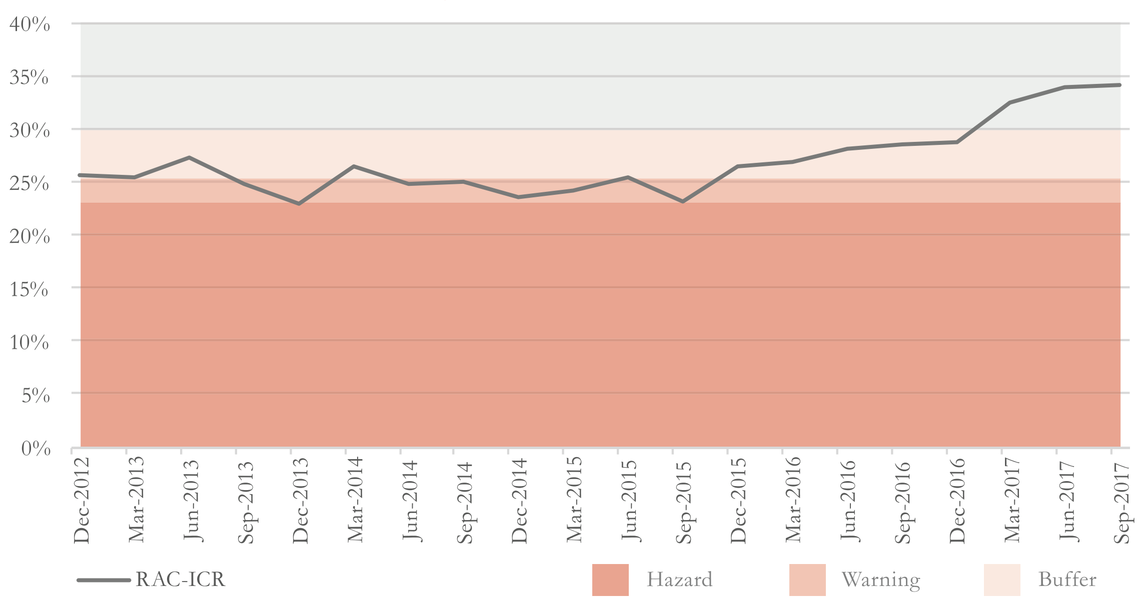
By September 2016, and thus well within the three years prescribed under IMM governance, IDB had exited the warning zone. Subsequently, the transfer of the FSO assets onto IDB's balance sheet on January 1, 2017, resulted in a big increase of the RAC, so that IDB reached full buffers for the first time since the introduction of the new ratings guidelines. IDB recently decreased its lending spreads for 2018 but kept the change modest (from 85 to 80 bps) pending more clarity on the new S&P ratings guidelines.[49]

FIGURE 5.1. EVOLUTION OF IDB's RAC-SACP RATIO



Source: OVE, based on various Financial Risk Reports.

FIGURE 5.2. EVOLUTION OF IDB's RAC-ICR RATIO

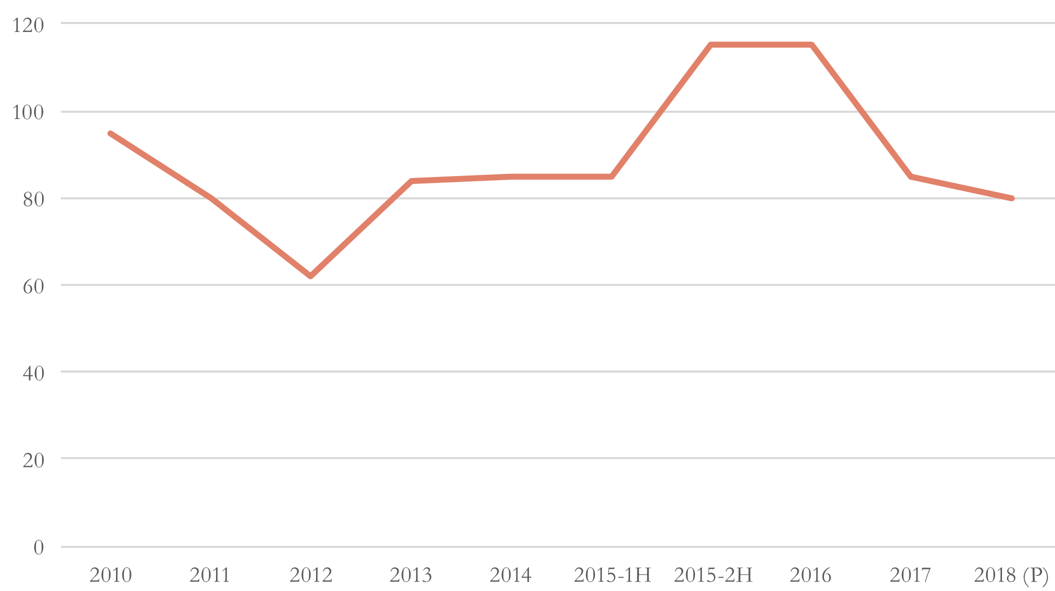


Source: OVE, based on various Financial Risk Reports.

D. Lending demand and price competitiveness

IDB's lending spreads during the IDB-9 period have fluctuated between a low of 62 bps over LIBOR in 2012 to a high of 115 bps in 2015-16 (Figure 5.3). At the current spread of 80 bps and with current fee structures, IDB's pricing is comparable to the World Bank's and less expensive than that of regional MDBs with lower credit ratings (CAF and CABEI). IDB is the only MDB with a "variable rate" model, meaning that any changes in its rates apply to the entire portfolio rather than just new loans. Thus, relatively small changes in rates have big effects on income.

Figure 5.3. IDB's Variable Lending Spread (bps)



Source: OVE, based on various Long Term Financial Projection Reports

Access to market financing has greatly improved for IDB's client countries during the IDB-9 period. Three countries – Chile, Panama, and Peru – can raise funds through bond issuance at lower rates than IDB offers, and the rates available to three others – Colombia, Mexico, and Uruguay – are only slightly higher than IDB's.[50] To date all of IDB's client countries are continuing to borrow from IDB. They value IDB's knowledge, technical cooperation, and project management skills (including safeguards, procurement, and M&E), and they want to preserve relationship with MDBs in case market rates rise in a future downturn. However, if a number of higher-middle-income countries were to cease borrowing, this would significantly increase IDB's concentration risk and thus affect capital requirements. More generally, it would change the nature of the Bank's business. While current market liquidity may be unusually strong and credit spreads unusually contracted as a result, the longer-term trends in LAC toward stronger market access are likely to continue as development proceeds.

If IDB is to stay vibrant and relevant in the region, it will need to be increasingly vigilant about its cost structure and the value-added of its financial and non-financial products.

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E. Conclusions

IDB has met the requirements of IDB-9 with regard to financial planning and risk management. The CAP and IMM have imposed discipline and made trade-offs more transparent (for example, between lending rates and lending or TC amounts). A prudent policy framework and financial management practices have helped steer IDB through a difficult period, while contributing to IDB's now significantly increased lending capacity. Risks remain on the horizon (notably potential changes in credit rating methodology), but IDB is in a strong position to continue to manage those risks.

The bigger challenge, related to but going beyond financial concerns, is competitiveness. As capital constraints have become less of a concern for IDB (assuming no negative changes in the rating methodology), demand may emerge as the main limit to increased lending. As LAC countries grow and develop, they are increasingly able to access financial markets at lower cost than borrowing from the Bank. This is an important indicator of successful development and good news for the LAC region and the development community. Pricing is not the only concern of borrowers, but it is an important one that all Ministers of Finance are obliged to consider as they make financing decisions. If IDB is to stay vibrant and relevant in the region, it will need to be increasingly vigilant about its cost structure and the value-added of its financial and non-financial products.

6

The IDB will emerge from IDB-9 as a stronger organization than it was in 2010. Though IDB-9 was overly prescriptive in some areas, it led the Bank to focus more on results and accountability and to improve many aspects of how it works.
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6 Overall Conclusions

The IDB-9 Agreement was very comprehensive, touching on a broad range of issues and processes relevant to IDB. That breadth has been mirrored in this report, which reviews a wide variety of topics covered by IDB-9 and seeks to draw conclusions about its effect on the Bank and lessons for IDB's future.

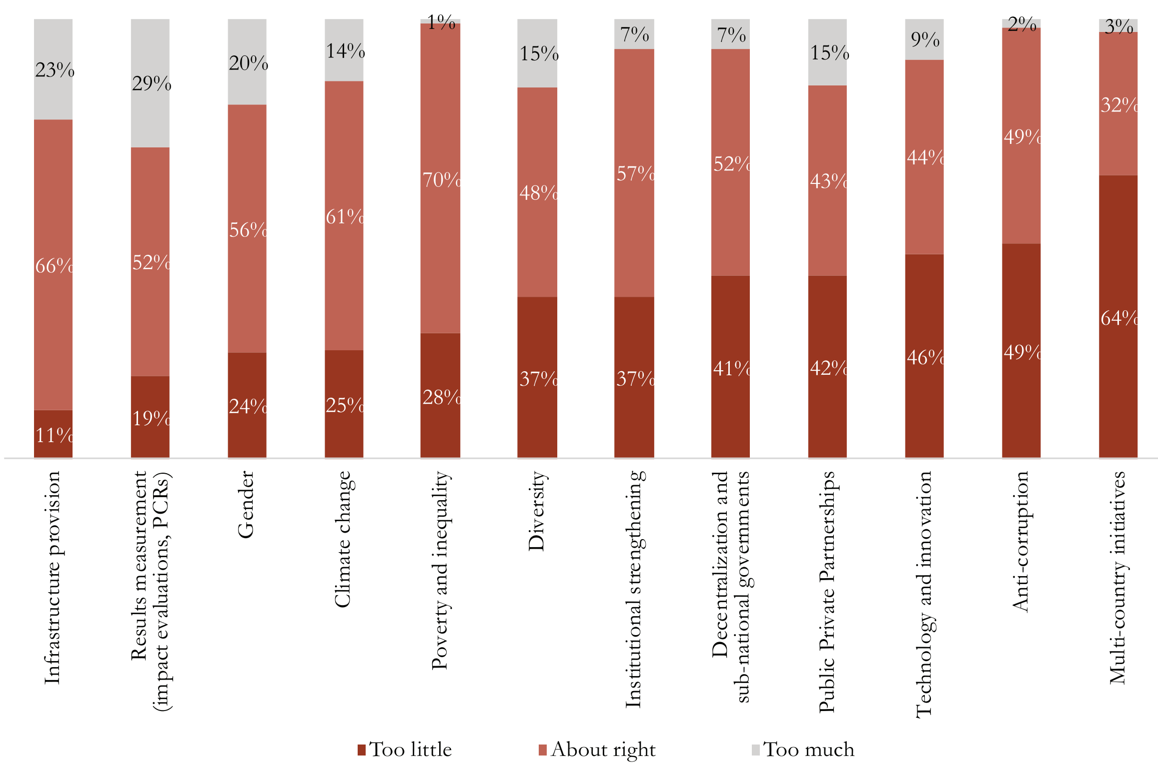
With regard to implementation, OVE finds that IDB has made extensive progress in implementing most of the IDB-9 mandates. The 2012 IDB-9 midterm evaluation documented progress through 2012 and made ten recommendations, of which nine (all but the sixth, on the Haiti program) were endorsed by the IDB Board. Of these nine, Bank management has made strong progress in implementing seven. Progress has been more modest on two: resource allocation processes and results monitoring for TC and capacity-building work (recommendation 4) and information disclosure (recommendation 9). Progress has also been made in implementing a number of IDB-9 mandates that were not covered by OVE recommendations in the midterm evaluation, including the adoption of RBB, the steady if sometimes slow progress on the country systems agenda, the implementation of new systems (SAP and Convergence) through the Optima program, and the strengthening of the Bank's ability to address issues of fraud and corruption.

With regard to results, OVE finds that progress toward achieving IDB-9's four intermediate outcomes has been significant though uneven. IDB is essentially a demand-driven bank, and a key lesson of IDB-9 is that some of the top-down mandates imposed on the Bank through IDB-9 do not fit comfortably in such an environment.

Regarding the first outcome, IDB-9 seems to have had only a modest effect on the Bank's strategic selectivity. Neither IDB-9's five mandated sector strategies nor its lending targets appear to have led to meaningful changes in Bank activities. The Bank's C&D country classification is increasingly outdated and is not the best tool to focus the Bank's support on the special needs of less developed countries. Indeed, there is little evidence that the Bank focused more on poverty and inequality than it had before (other than in Haiti, where results have been limited to date), though a broad emphasis on economic growth does encompass much of what the IDB does and is also important to poverty reduction. The 2015 private sector merge-out has the potential to strengthen the Bank Group's effectiveness in supporting development through the private sector, but strong leadership will be needed to overcome the centrifugal tendencies inherent in the organizational structure and take advantage of IDB Group synergies to have the strongest impact.

IDB-9 appears to have had a more significant effect on the second outcome, enhanced client responsiveness and development effectiveness. The Bank has developed a comprehensive and flexible set of lending products and has invested heavily in country diagnostic work, knowledge generation, and tools to enhance development effectiveness, though further work is needed to prioritize and streamline these efforts. Macroeconomic safeguards and the ICIM have been reformulated to correct initial problems under IDB-9. While the Bank is making progress in helping countries develop fiduciary systems and address governance and anticorruption, more attention is needed to these issues given the pervasive problems of Bank projects in countries with weak institutions. According to Bank staff surveyed by OVE, the Bank is giving about the right amount of attention to many development issues, though still too little to a few (Figure 6.1), including multicountry initiatives and anticorruption.

Figure 6.1. Bank's Attention to Development Issues



Source: OVE, n=259

Regarding the third outcome, the Bank has made meaningful improvements but there is still room to enhance its efficiency, accountability, and transparency. Many of the Bank's internal processes, systems, and oversight functions – RBB, IT, Ethics, OII – have been strengthened, though continued work will be needed to expand their reach and effectiveness. Information disclosure also improved in the early years of IDB-9 but has stalled somewhat since OVE's midterm evaluation. Strong leadership and incentives are needed for these efforts to translate into further gains in efficiency, accountability, and transparency.

Finally, the Bank has taken proactive and successful steps to address risks to financial sustainability during the IDB-9 period, but it is likely to face increased challenges of competitiveness going forward. LAC countries are increasingly able to access financial markets, often at lower cost than borrowing from the Bank. IDB will need to increasingly scrutinize its cost structure and the value-added of its financial and non-financial products if it is to stay relevant to borrowers across the LAC region.

In closing, OVE would like to highlight five broad lessons for IDB emerging from this evaluation:

- **Lending patterns and trends in the Bank tend to change slowly from year to year, primarily in response to country demand and country conditions, and top-down lending mandates are rarely effective in this context.** If the IDB Governors decide to pursue another capital increase in the future, they are advised to weigh the costs and benefits of top-down mandates and consider carefully their relevance and likelihood of success in the context in which the Bank operates.

- **IDB-9's heightened attention to the measurement and documentation of results was well-placed, but further work is needed to make it a reality.** The Development Effectiveness Framework is a strong set of tools but has become bureaucratized over time. The DEM had a powerful impact when introduced but appears to have lost some meaning, as results frameworks are often revised during project implementation. The PMR focuses on physical and financial outputs but does not get to the heart of what matters – whether development outcomes will likely be achieved – in reporting on progress during the life of a project. And though the Bank has made steady albeit slow progress on PCRs since 2010, even after seven years the Bank has not settled into a smooth and timely process for producing them. Finally, the DEO is not oriented toward reporting fully and candidly on IDB's development effectiveness. It is critical for IDB to monitor, evaluate, and report clearly and accurately on development results if it expects to achieve them, and renewed effort to meaningfully implement the DEF is warranted.

With regards to results, OVE finds that progress toward achieving IDB-9´s four intermediate outcomes have been significant though uneven. IDB is essentially a demand-driven bank, and a key lesson of IDB-9 is that some of the top-down mandates imposed on the Bank through IDB-9 do not fit comfortably in such an environment.

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- **One of the Bank's most important but difficult challenges — both in supporting development in LAC and in ensuring success in its own projects — is to help countries strengthen institutional capacity and governance.** Despite IDB-9's emphasis on poverty, institutional strengthening, and anticorruption, IDB has had great difficulty achieving results in countries with weak governance and institutional capacity. The extreme case is Haiti, where the IDB has approved US$1 billion of grants but struggled to achieve significant results, and other cases are documented in OVE's CPEs. A renewed look at IDB project designs and at staff incentives to deliver results in these settings — and more generally at IDB's ability to support countries in improving governance and strengthening institutional capacity — is warranted.

- **Promoting openness and transparency is a worthy goal of all MDBs, and IDB should make a renewed push in this direction.** IDB is a public organization funded with public money serving public and humanitarian ends, and citizens of both borrowing and funding countries deserve to know how their funds are being spent. IDB's reputation is already strong, and its credibility will only improve with increasing openness and transparency.

- **IDB is likely to face increasing challenges of relevance and competitiveness as LAC countries continue to develop, and greater consensus is needed on what kind of institution IDB wants to be.** OVE's interviews for this evaluation highlighted the wide variety of views among Bank stakeholders on what IDB should seek to be.

The IDB will emerge from IDB-9 as a stronger organization than it was in 2010. Though IDB-9 was overly prescriptive in some areas, it led the Bank to focus more on results and accountability and to improve many aspects of how it works. The work is not yet complete, however, and IDB-9's four intermediate objectives remain highly relevant. IDB should continue to build on the successes it has achieved while moving proactively to develop a consensus on the kind of Bank it wants to become.

Notes

1 The *Midterm Evaluation of IDB-9 Commitments* (RE-425) consisted of an overview paper and 22 background papers. The Board held a series of individual discussions on the background papers, and the overview paper was presented at the Annual Meeting of the Board of Governors in Panama in March 2013.

2 Cárdenas, Mauricio, and Camila Henao. "Latin America and the Caribbean's Economic Recovery." Brookings Institution, 2010.

3 IMF, *World Economic Outlook Update*, October 2017 edition.

4 OECD/CAF/ECLAC (2016), *Latin American Economic Outlook 2017: Youth, Skills and Entrepreneurship.*

5 The share of population in LAC living on less than US$4 a day (2005 PPP) declined from 43% to 24% from 2000 to 2015, while the middle class ($10-$15 2005 PPP) increased from 21 to 35 percent during the same period. World Bank, http://www.worldbank.org/en/topic/poverty/lac-equity-lab1/poverty.

6 ILO, *2016 Labor Overview*.

7 World Bank, http://www.worldbank.org/en/topic/poverty/lac-equity-lab1/poverty.

8 Non-reimbursable assistance through technical cooperation grants (TCs) was also 39% higher in 2012-2015 than in 2006-2009. Though lending and TC approvals are positively correlated, some countries with small lending portfolios – such as Barbados, Bahamas, Belize, and Trinidad and Tobago – benefitted from greater technical assistance support after IDB-9.

9 The year-over-year correlation in amounts lent to individual borrowing countries during the 2006-2016 period was 79%. Also, econometric analysis conducted by OVE suggests that a 1% increase in IDB approvals in a given year is associated with a 0.75% increase in approvals the following year (see background note on lending trends for details).

10 The C&D countries are The Bahamas, Barbados, Belize, Bolivia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Nicaragua, Panama, Paraguay, Suriname, Trinidad and Tobago, and Uruguay.

11 Action Plan C+D was originally funded by a mixture of ordinary budget and Fund for Special Operations (FSO) net income (US$2 million). In IDB-9, all funding from FSO net income was suspended, and part of Action Plan C+D became the Small and Vulnerable Countries Special Program (Window II). Its funding, as the name of the program indicated, was changed to the net income of the OC. Aside from that, there were no major changes in the program.

12 In addition, the recent drop in oil prices has led to a significant reduction in contributions by Petrocaribe to the Government of Haiti.

13 In late 2017 IDBG management rebranded the Inter-American Investment Corporation (IIC) as "IDB Invest." For consistency this evaluation uses IIC throughout.

14 *Strategies, Policies, Sector Frameworks and Guidelines at the IDB*, revised version, GN-2670-1.

15 SFDs should address the following: "(i) definition of the development challenges in the sector and the problems that the Bank seeks to address; (ii) identification of the specific areas of activity that the Bank should undertake within the sector, including an analysis of where the Bank can be most effective; (iii) classification of the types of intervention that have proven to be effective and synthesis of the empirical evidence that supports this assertion; (iv) definition of the specific areas of uncertainty regarding their development effectiveness; (v) identification of the key knowledge and capacity building work underway; (vi) synopsis of latest DEM [Development Effectiveness Matrix] results for IDB projects in the sector in previous operations; (vii) synthesis of OVE's evaluations of development effectiveness and evaluability of past projects, as well as discussion as to how they should be addressed; and (viii) any other element considered relevant to improve the quality of the Bank's operational and analytical work in a context of continuous learning and updating."

Notes

[16] All the SFDs to date have had the same structure of five sections: (i) the SFD in the context of the Bank's regulations and institutional strategy; (ii) international evidence in the sector; (iii) main achievements in the sector in the region, and challenges that the Bank seeks to address in the sector in LAC; (iv) lessons learned from the Bank's interventions and comparative advantages that the Bank possesses in that sector; and (v) targets (goals), principles, dimensions of success, and lines of action that will guide the sector's activities in the following years.

[17] The four levels of the original CRF were (i) Regional Development Goals; (ii) Output Contributions; (iii) Lending Program; and (iv) Operational Effectiveness and Efficiency.

[18] About 65% of the IDB performance indicators (level 3) lacked baselines and/or targets when the new CRF came out, partly due to the timing just prior to the private sector merge-out, when it was not yet possible to establish baselines and targets for the new IIC. There has been improvement since then, and many gaps in targets were filled when the IIC Board approved the CRF in December, 2016.

Some indicators could still benefit from clearer definition, such as those on jobs created and on micro, small, and medium-sized enterprises financed and supported.

[19] OVE reviewed the first four CSs approved under the new guidelines (Argentina, Peru, Suriname, and Trinidad and Tobago) and four CSs piloted under the new guidelines before they formally took effect (Bolivia, Brazil, Colombia, and Jamaica).

[20] There are two main differences between the LBR and the World Bank's equivalent (the Program-for-Results, or PforR): (i) the IDB instrument falls within the investment lending category, while the WB created a new lending category for PforR, which makes the instrument more flexible in some ways; and (ii) the IDB's LBR disburses mainly against intermediate and final outcomes, whereas the WB's PforR can disburse against outputs, which makes it easier and faster to disburse.

[21] As a comparison, the World Bank now has only one. In 2012, the WB consolidated its many forms of investment lending under a single instrument with sufficient flexibility to handle a wide range of client needs. A major motivation was to deal with the proliferation of at least 35 separate policies and procedures: the large number of policies and instruments, with overlaps and inconsistencies, generated a serious operational compliance risk.

[22] The WB and the Asian Development Bank have only two Board approval procedures — full Board discussion (IDB's equivalent for standard procedure) and absence of objection (which *de facto* merges both IDB's simplified and short procedures) — as well as delegation of authority to management.

[23] The percentage of specific investment loans that were above the ceiling to be eligible for the simplified approval procedure went from 26% in 2006 to 40% in 2016. The size of these loans almost doubled in the same period, going from a mean of US$39.4 million in 2006 to US$72.4 million in 2016.

[24] *Knowledge Generation and Dissemination in the Inter-American Development Bank Group,* forthcoming, 2018.

[25] *Policy Proposal for Fee-Based Advisory and Knowledge* Services at the IDB, GN-2706-1. The policy provided that management would evaluate the policy three years after its approval, and this review is currently underway.

[26] The World Bank Group, which does not offer TC grants funded from OC, has seen a significant increase in demand for fee-based services in recent years.

[27] *Evaluation of Special Programs Financed by Ordinary Capital*, RE476-5; *IDB's Impact Evaluations: Production, Use, and Influence*, RE512-1. In early 2018 OVE will complete an evaluation of the production and dissemination of knowledge in the IDBG, which is expected to some of these themes.

[28] IDB-9 Agreement, *Annex 1, IDB-9 Results Framework 2012-2015.*

29 In 2014, 7.8% of PMRs were upgraded (5.6% upgraded to satisfactory) and 1.1% downgraded. In 2017 the classification was upgraded in 11.1% of PMRs (and upgraded to satisfactory in 9%) and downgraded in 0.5%, with other changes in the remaining 0.6% of cases with reclassifications. The share of PMRs that were upgraded and those upgraded to satisfactory has increased in each year between 2014 and 2017. Though not necessarily the motivating factor, these upgrades have helped IDB reach the target in the CRF for PMRs rated satisfactory.

30 *IDB and IIC Project Performance: OVE's Review of 2016 PCRs and XSRs*, RE-521-1. This OVE review also validated self-evaluations of NSG projects done by IIC.

31 OVE is currently undertaking an evaluation on environmental and social safeguards in the IDB Group and another on the IDB's approach to gender and diversity. These topics were not central to IDB-9 and are not covered in this evaluation.

32 *Evaluation of Macroeconomic Safeguards at the IDB*, RE-508-1.

33 OVE's forthcoming evaluation of the IDBG's safeguards framework, to be completed in 2018, will assess ICIM's role and evolving impact in greater detail.

34 *Strategy for Strengthening and Use of Country Systems*, GN-2538.

35 OVE's midterm evaluation summarized this trend, and the background note to this evaluation goes into substantially greater detail. OVE estimates that the Bank financed some $400 million of explicit anticorruption activities between 2007 and 2015, about US$27 million of which was channeled through 61 non-reimbursable TC grants (almost half from the Anticorruption Activities Fund). The Bank's portfolio in public financial management (PFM), a topic closely related to anticorruption and governance, included 39 approved loans between 2007 and 2015 amounting to US$1.5 billion, plus an additional US$64 million in TCs.

36 These include, for example, recent OVE CPEs for Bahamas, Guatemala, Guyana, Haiti, Suriname, and Trinidad and Tobago.

37 This cost estimate was derived by OVE from IDB data on personnel and non-personnel costs of Optima-related activities and products, whether financed by the administrative or the capital budget.

38 In addition to increases in the numbers of women in professional positions, the Bank has invested substantial resources during IDB-9 in career development and work-life balance initiatives to better attract, support, and retain talented women.

39 The target for decentralization was replaced in the CRF by "time spent by IDB senior technical specialists supporting loan operations in small and vulnerable countries."

40 On the input side, the Bank's administrative spending grew by 24% in nominal terms between 2010 and 2015, while staff numbers grew by 8% and consultants by 135% (in full-time equivalents) between 2008 and 2015. On the output side, the average volume of annual lending and disbursements did not change much between 2010 and 2015, though the production of knowledge products and TC expanded considerably.

41 The International Aid Transparency Initiative rates IDB favorably among aid donors in the extent of disclosure of project-related information. http://ati.publishwhatyoufund.org/index-2016/results/.

42 The net present value of the paid-in capital minus the outflow to Haiti was roughly zero (depending on the discount rate used), given their differences in timing.

43 At the time, IDB's borrowing capacity was constrained by its "unused borrowing capacity" (UBC) policy, which limited net borrowing to subscribed callable capital stock of non-borrowing member countries and required IDB to have at least US$2 billion of unused borrowing capacity. OVE's midterm evaluation suggested that the UBC was outdated and should be replaced. IDB management agreed with that recommendation and the Board has recently agreed to replace the UBC (FN-711).

44 One of the IMM's requirements is that loan charges should cover at least 90% of OC (non-FSO) administrative spending on a three-year rolling weighted average basis.

Notes

[45] Ordinary Capital Income Management Model. Revised version (GN-2518-36) and AB2764.

[46] However, only callable capital at or above the ICR—in IDB's case AAA—would be counted.

[47] IDB's OC Liquidity Policy was subsequently also revised in March 2015.

[48] Other changes included, for example, the time horizon (to be more aligned with other MDBs), confidence intervals, using simplified balance sheet and income statement projections, preferred creditor treatment based on historical performance, etc.

[49] As noted earlier, pending changes in S&P's rating methodology have also introduced renewed uncertainty. While the proposal to count all callable capital at or above IDB's SACP or AA+ (rather than the ICR of AAA) would benefit IDB, changes in how IDB's preferred creditor treatment (PCT) is assessed could have either a positive or negative impact, and potentially of high magnitude. Future transfers could also have a temporarily negative effect on IDB's capital position. The biggest transfers IDB is envisaging over the next six years are to the IDB Trust Fund for Haiti and to IIC (in addition to annual transfers to fund TCs — US$107 million in 2018 — and any possible future transfers to support MIF).

[50] Fixed rate cost comparison between IDB and borrowing countries, as of October 16, 2017, provided by FIN.