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ASSESSMENT OF THE EFFECTIVENESS OF THE POLICY-BASED LENDING INSTRUMENT OF THE CARIBBEAN DEVELOPMENT BANK

Presenter : Anne Bramble
Head (Acting)
Office of Independent Evaluation

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STRUCTURE OF THE PRESENTATION

BACKGROUND

CONTEXT

INSTITUTIONAL CAPACITY

RISK MANAGEMENT

RECOMMENDATIONS

QUESTIONS AND DISCUSSION

BACKGROUND

- **PBL PROGRAMME LAUNCHED in 2006**
- **DEMAND AS WELL AS SUPPLY-SIDE DRIVEN**
- **INVESTMENT LENDING WEAKER - fiscal constraints made counterpart funding more difficult**
- **COMPETITION FROM OTHER MDBs**
- **PBLs ARE INTENDED TO INCENTIVISE REFORMS AND ENSURE THAT THE REFORMS ARE WELL-DESIGNED AND IMPLEMENTED SO THAT THE ULTIMATE OBJECTIVES ARE LIKELY TO BE ACHIEVED**
- **THE SIZE OF THE PBL IS RELATED TO THE FINANCING GAP THAT NEEDS TO BE CLOSED TO ACHIEVE THE OBJECTIVES OF MEDIUM-TERM FISCAL AND/OR DEBT SUSTAINABILITY AND SECTOR REFORMS AND TAKE INTO ACCOUNT THE IMPACT OF POLICY MEAURES**
- **PBLs ARE IN EFFECT GENERAL BUDGETARY SUPPORT**
- **TWO INDEPENEDENT REVIEWS WERE UNDERTAKEN IN 2010 AND 2011**

PBL OPERATIONS

PBL OPERATION	No	US$m
PB Grant (Haiti) PB Loans	1 10	10.0 374.8
SDF OCR & SDF OCR	1 5 5	10.0 127.8 247.0
Status Active Completed Dated Conditions	 3 6 2	 87.8 252.0 45.0
Disbursed Outstanding	11 3	357.4 27.4
Type of Operations Single Tranche Multi Tranche	 3 8	 90.0 294.8
Total PBL Operations	11	384.8

CONTEXT

- **Five aspects of the current context of the Bank's PBL operations can be identified:**

  - **The Global Recession**
  - **Rating Downgrade**
  - **Fiduciary Safeguards**
  - **CDB Resource Constraints**
  - **SDF Replenishment**

CONTEXT

GLOBAL RECESSION

- BMCs facing a prolonged recession – weak or negative growth and constrained fiscal operations

- The demand for PBLs has increased

CHANGING CONTEXT

RATING DOWNGRADE

- **Prompted by shortcomings in Bank's risk management and financial planning capacity, its unfavorable capital adequacy ratios and the unfavorable credit quality of its BMCs**

<u>IMPLICATIONS</u>

- **the Bank's cost of borrowing will increase over the medium term and CDB will probably need to increase ending to BMCs that have better credit ratings**

CONTEXT

FIDUCIARY SAFEGUARDS

The Board of Directors has to be mindful :

- **whether the conditionalities, supervision and monitoring of PBLs are sufficiently credible and strong so as to give the Board the degree of comfort it requires that it has discharged its fiduciary obligations to the highest possible standard; (this relates to the Bank's institutional capacity to design, supervise and monitor); and**

- **whether the terms of the loan, specifically the tenor, are appropriately linked and aligned with the duration of the expected outcomes and the particular circumstances of the borrowing country**

INSTITUTIONAL CAPACITY

- **The Bank's capacity to design, supervise and monitor PBLs were extensively discussed in a previous (2011) consultancy report. The recommendations of that report are in the process of being implemented.**

- **The CDB has trained, capable economists. However the *number* of economists is probably not sufficient to ensure segregation of duties and minimization of any potential conflict of interest consistent with best practice.**

- **The Bank collaborates with other MDBs and the IMF and also makes use of consultants. The Bank has collaborated effectively in the PBL operations in Jamaica, Antigua and Barbuda, and Belize.**

EFFECTIVENESS

- **PBLs have facilitate improvements in frameworks for macroeconomic management, fiscal policy, debt management and overall public finance administration and helped avoid severe fiscal crisis and liquidity shortages in the financial system**

- **It is difficult, arguably impossible, to assess definitively the effectiveness of a lending operation targeted at policy reforms. The lending institution has to assume that the reform or institutional change will bring about the desired outcome.**

- **It can seek to determine whether and to what extent the policy loan conditionalities were met, whether there has been (real) progress in the reforms and institutional changes proposed and use such quantitative indicators as it can devise to make a proper determination.**

- **In addition, even where the reforms and institutional changes have been made, the question of attribution remains given that there are always many factors at play, internal and external to the country, economic as well as political. Unambiguous attribution of outcomes to a lending operation is rarely possible.**

EFFECTIVENESS

- **The PBL operations have been partially successful in that in several operations the conditions marked to be achieved were assessed to have been achieved.**

- **There have been easy and 'quick wins' in the case of Anguilla where the PBL was used for debt restructuring and in the case of St Vincent and the Grenadines, where the PBL (No. 2) supported the divestment of the state-owned commercial bank.**

- **Instances where the operations appear to be less than successful reflect, in part, the difficult global economic environment and in part, weaknesses of implementation which have led to delays in meeting conditions, waivers and scope revisions.**

- **In a few instances, disbursements have been effected where conditions have been deferred through board-approved waivers**

EFFECTIVENESS

- **“Sector/PBL instruments (including emergency PBLs) have dual objectives of providing country finance in times of stress and supporting policy reforms. They have been generally successful in accomplishing their country finance objectives, although the long-term returns to this activity are difficult to establish. It is even more difficult to establish their effectiveness in inducing policy change, given the multiple determinants of such change, the changing nature of desired reforms, and the nature of the link between policy reform and economic results”**

(Source IDB, Instruments and Development, August 2004

SUMMARY OF PBL OPERATIONS

COUNTRY	PBL SUMMARY	COMMENTS
Anguilla (2010)	US$55m (OCR-100%); for Debt Restructuring	PBL objectives achieved; strong political commitment via Governor of the territory.
Antigua and Barbuda (2009)	US$30m in 3 tranches (one tranche undisbursed at July 2012)	In progress; high completion rate of conditions; effected in conjunction with IMF Stand By Arrangement
Barbados (2010)	US$25m single tranche to 'ease fiscal strain' and protect social gains	This was an "ex post" PBL (conditions already fulfilled); no conditions related to foreign exchange outlook given debt profile; rating downgrade in July 2012. Concerns remain.
Belize (2006)	US$25m (OCR-60% and SFR-40%) in two tranches to close fiscal financing gap and facilitate debt restructuring	Policy conditions set by CDB were achieved, but the country has since regressed with another debt restructuring imminent.
Grenada (2009)	US$12.8m in 3 tranches (originally 2 tranches) (OCR- 37.5% and SFR-62.5%) to strengthen economic management and social policy frameworks	In progress at June 2012; most conditions are marked 'achieved' with minor delays in some instances, but the fiscal situation has deteriorated; this has been attributed to adverse external factors. Waiver granted
Jamaica (2008)	US$100m in 3 tranches as part of program with other MDBs to improve 'debt dynamics' and economic management	Loan conditions have been marked 'achieved'; however, Jamaica has since regressed and is reportedly engaging with the IMF for a new SBA.

SUMMARY OF PBL OPERATIONS

COUNTRY	PBL SUMMARY	COMMENTS
St Kitts and Nevis (2006)	US$20m (OCR-60% and SFR-40%) to improve 'debt dynamics' by replacing high cost debt	Some reforms achieved, but PBL objectives not fully realized owing to global crisis; full disbursement, although 3 conditions remain unmet.
St Lucia (2008)	US$45m (OCR-60%; SFR-40%) in 3 tranches to build institutional capacity and expand fiscal space	In progress. Most conditions have been satisfied. Notably the majority of conditions in high priority areas such as revenue administration and debt management have been completed. Significant progress also made in management of social sector initiatives. Outstanding conditions are in an advanced stage of completion. Waivers granted.
St Vincent and Grenadines (2009)	US$25m in 2 tranches (OCR-64%; SFR-36%) to preserve fiscal and debt sustainability	Three conditions outstanding at June 2012;
St Vincent and Grenadines (2010)	US$37m, single tranche (OCR-100%); sector PBL to restructure and divest National Commercial Bank of SVG and maintain domestic financial stability	Conditions achieved.

RISK MANAGEMENT

- **PBL operations pose a challenge for the Bank's risk management.**
- **The Operational Policy and Guidelines for PBLs:**
  - **sets the limit of 20 percent of total outstanding loans ;**
  - **identifies the sets of analyses to be done on the borrowing country but does not identify a requirement for (a) the implications of the PBL for the Bank's own prudential indicators and risk management, nor (b) the process by which waivers, deferrals and scope revisions would be assessed and approved by the Board**
- **PBLs have been made mainly to the Bank's smaller BMCs whose own international credit ratings are now weaker.**

RISK MANAGEMENT

- International capital markets are not propitious and are leery about emerging market exposure
- The Bank is in a position where it has a maturity mismatch. This situation is likely to persist for a few more years until the global economy has recovered sufficiently to enable a return to growth in the region
- There would appear to be no cogent reason why a PBL which is intended to incentivize or enable reforms over the medium term need to be extended for as long as 20 years.

RECOMMENDATION

1. **The PBL program should be continued in order to:**

   (a) meet the demand for quick-disbursing resources to support policy reforms in the context of a prolonged global recession, and

   (b) ensure that the CDB remains a relevant and competitive source of external financing to its BMCs.

2. **The limit on PBLs should be raised to 33 percent subject to and contingent upon the Bank's management putting in place the following measures to the satisfaction of the Board:**

   – **The tenor of PBLs should be flexible and range from 7 years for the larger BMCs to not more than fifteen (15) years for the smaller BMCs; this will align the tenor of the PBL with the completion of the reforms and the evidence of the outcomes as well as mitigate the maturity mismatching;**

RECOMMENDATIONS

- **The (revised) limit of 33 percent will end automatically and revert to 20 percent in 2017 unless continued by the Board; this sunset provision recognises that the current circumstances propelling the demand for PBLs is a function of the current global crisis and that the Bank must maintain focus on its project lending mandate. The expectation would be that management will manage the process to ensure that the limit can be brought down by 2017 or alternatively make the case for further extension based on a review of the global and regional economic environment.**

- **As a matter of urgency, the CDB should complete the revision of the Operational Guidelines as recommended by the 2011 Review Report (DaCosta Report #2) to provide for the specific conditions under which the Board will be asked to approve waivers, deferrals, supplementary financing and scope revisions of PBL conditionalities.**

RECOMMENDATIONS

3. **Before a PBL is approved, the Board should be satisfied that the circumstances of the country do not require currently or prospectively an IMF Stand By Arrangement, whether or not the BMC has decided to proceed with its own (home-grown) adjustment program. Where the IMF has indicated that a Stand By Arrangement is currently or prospectively required, the CDB will not provide a PBL to the BMC until and unless it has received notification from the IMF that the country's 'home-grown' program of adjustment is likely to be adequate. This does not preclude the CDB from assisting the BMC in developing and designing its 'home-grown' adjustment program**.

RECOMMENDATIONS

4. **If the CDB determines that it has the financial capacity to do so, it should increase the number of economists to ensure that BMCs with a PBL operation are supervised and monitored by a dedicated senior economist who is segregated from duties relating to preparation of that country's CSP. The CDB should also, if financially feasible, seek to employ economists from outside the region on 3 year non-renewable contracts, to assist in minimising the possibility of conflict of interest.**

5. **Whether or not the CDB employs additional economists as recommended above, it should intensify its cooperation and collaboration with the IMF, the World Bank and the IDB, and leverage the capacity of those IFIs in the design, supervision and monitoring of its PBL operations. Alternatively, or in addition, provided that BMCs do not have concerns, the use of consultants can be expanded beyond PCRs to surveillance and monitoring.**

DISCUSSION

THANK YOU FOR YOUR ATTENTION

COMMENTS?

QUESTIONS?