CARIBBEAN DEVELOPMENT BANK

PREPARATORY MEETING OF CONTRIBUTORS ON A REPLENISHMENT OF RESOURCES OF THE UNIFIED SPECIAL DEVELOPMENT FUND FOR THE EIGHTH CONTRIBUTION CYCLE

TO BE HELD IN BARBADOS

DECEMBER 9, 2011

IMPLEMENTATION OF THE REVISED COUNTRY CLASSIFICATION SYSTEM AND TERMS OF LENDING FOR COUNTRY GROUPS OF THE SPECIAL DEVELOPMENT FUND (UNIFIED)

At the 28th Annual Meeting of Contributors, held in Trinidad and Tobago on May 24, 2011 Contributors approved the revised Country Classification System and Terms of Lending which would be used to determine eligibility for access to the Special Development Fund (Unified) [SDF (U)] resources, as well as the terms and conditions of access. The attached paper sets out the implementation arrangements for the revised Country Classification System which will take effect from the Special Development Fund (Eighth Cycle).

The attached paper on the Implementation of the Revised Country Classification System and Terms of Lending for Country Groups of the SDF (U) is submitted for the consideration of SDF Contributors.

CARIBBEAN DEVELOPMENT BANK

SPECIAL DEVELOPMENT FUND (UNIFIED)

IMPLEMENTATION OF THE REVISED COUNTRY CLASSIFICATION SYSTEM AND TERMS OF LENDING FOR COUNTRY GROUPS OF THE SPECIAL DEVELOPMENT FUND (UNIFIED)

NOVEMBER 2011

ABBREVIATIONS

BMCs	-	Borrowing Member Countries
CDB	-	Caribbean Development Bank
GDP	-	Gross Domestic Product
GNI	-	Gross National Income
mn	-	million
OCR	-	Ordinary Capital Resources
p.a.	-	per annum
PPP	-	Purchasing Power Parities
SDF (U)	-	Special Development Fund (Unified)
SDF 8	-	Special Development Fund (Eighth Cycle)
UN	-	United Nations

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APPENDICES

1. BACKGROUND

1.01 The Caribbean Development Bank (CDB) uses a country classification mechanism for determining eligibility for access to the Special Development Fund (Unified) [SDF (U)] as well as the terms and conditions of access. For the SDF (U) (Seventh Cycle) [SDF 7], Contributors agreed that the country groupings and terms of lending to be applied in SDF 7 should remain unchanged from the SDF (U) (Sixth Cycle). They also required that the basis for setting the country groups should be reviewed and the results of the review submitted to Contributors for further consideration. An independent consultant was engaged to review the system, and the Consultant's report with a set of recommendations was presented to Contributors at the 27th Annual Meeting of Contributors held on May 18, 2010 in Nassau, The Bahamas. The report was subsequently revised to take account of the comments received from Contributors.

1.02 Papers BD 39/11 and SDF 7/28 - AM-5 entitled *"Review of the Special Development Fund (Unified) Country Classification and Terms of Lending for Country Groups and Management's Response Thereto"* were considered at the 246th Meeting of the Board of Directors (BOD) on May 23, 2011 and at the 28th Annual Meeting of Contributors on May 24, 2011, respectively. The BOD and Contributors approved the recommendations as set out in Appendix 1.

1.03 The purpose of this paper, therefore, is to remind Borrowing Member Countries (BMCs) of the changes in the country groupings and terms of lending which will be applicable from SDF 8, which is targeted to commence on January 1, 2013.

2. COUNTRY GROUPS AND TERMS OF LENDING EFFECTIVE SDF 8

2.01 In accordance with the recommendations of Paper BD 39/11 and SDF 7/28 - AM-5, the United Nations' (UN) per capita Gross Domestic Product (GDP) (at constant 2005 prices)[1/] has been used to classify BMCs into their respective country groups. Accordingly, the country groups and associated terms of lending which are proposed to apply, effective SDF 8, are shown in Table 1 with details being presented in Appendix 2.

2.02 The use of this updated data has resulted in Antigua and Barbuda and Barbados being reclassified to Group 1 countries from Group 2. The Paper recommended that Group 1 terms continue to apply to Barbados (Recommendation No 1.5) thus the updated grouping will have no impact for Barbados. In the case of Antigua and Barbuda, being classified as Group 1 will restrict its access to SDF resources as it will be eligible mainly for Ordinary Capital Resources (OCR) funding. All other country group classifications will remain as proposed in the paper. A comparison of the proposed country classifications and terms of lending for SDF 8 with SDF 7 is presented in Appendix 3.

[1/] The base year for the GDP constant dollar calculations has been updated to 2005 prices from the 1990 prices which were used in the Consultant's report

TABLE 1: COUNTRY GROUPS AND TERM OF LENDING (EFFECTIVE SDF 8)

Country Group	Country	Term of Lending
Group 1 (OCR Mainly)	• Anguilla • Antigua and Barbuda • Bahamas, The • Barbados • British Virgin Islands • Cayman Islands • Trinidad and Tobago • Turks and Caicos Islands	Interest rate – 2.5% Maximum Grace Period – 5 years Maximum Overall Maturity – 20 years
Group 2 (SDF-OCR Blend)	• Belize • Dominica • Grenada • Jamaica • Montserrat [a/] • St. Kitts and Nevis • St. Lucia • St. Vincent and the Grenadines	Interest rate – 2.5% Maximum Grace Period – 5 years Maximum Overall Maturity – 25 years
Group 3 (SDF-mainly)	• Guyana • Haiti	Interest rate – 2.0% Maximum Grace Period – 10 years Maximum Overall Maturity – 30 years

[a/] Exception for Group 3 terms and conditions to apply

Next Steps

2.03 There were two recommendations contained in the matrix of the Management's Response (Paper BD 39/11) which required further consideration by Management. With regard to the recommendation (No. 1.6)[2/] that the cap on SDF (U) access for Group 1 countries should not apply to BMCs with a population below 30,000, Management agreed on the need for introducing a mechanism to improve the access of these BMCs to SDF resources based on their peculiar vulnerabilities. Options are being examined with a view to making recommendations for consideration by Contributors during the SDF 8 replenishment discussions.

[2/] The cap on SDF access for Group 1 countries should not apply to BMCs with a population below 30,000. The non-application of this cap will allow the affected BMCs - Anguilla, British Virgin Islands, and Turks and Caicos Islands – to participate in the SDF resource allocation exercise. In addition, it is also recommended that these countries be granted access to SDF on Group 2 terms and conditions. The countries with the smallest population are among the most vulnerable BMCs and, therefore, least able to cope with the challenges and adverse effects of exogenous shocks. Based on the vulnerability index prepared for 95 countries, Anguilla, and British Virgin Islands were ranked first and sixth[2/], respectively. The vulnerabilities of these BMCs present additional challenges with respect to economic and social infrastructure, including providing logistical support and security services. The situation in the multi-island territories is further compromised by a high level of illegal immigration and the attendant pressures on education, health and other social services.

2.04 Management is also assessing the full implications of the recommendation (No. 4.2)[3/] of maintaining at least a one percentage point differential between the SDF (U) and OCR interest rates, on the financial performance of the Fund.

2.05 Consistent with the practice at previous replenishment negotiations, there will be an assessment of the terms and conditions for access to SDF resources as part of the SDF 8 replenishment discussions.

3. REQUEST

3.01 Contributors are asked to note the effective implementation date of January 1, 2012 for the changes to country groupings and terms of lending.

[3/] At the operational level, an effort should be made to maintain at least a one percentage point differential between the SDF (U) and OCR interest rates. The narrowing of the gap towards that limit should provide a trigger for the review of the SDF (U) interest rate to minimise the risk of convergence of the two rates. In the event that the Bank's management determines that, based on trends in the OCR interest rate, the differential is likely to be one percentage point or less in the next semi-annual adjustment of the OCR rate, a proposal for SDF (U) rate adjustment, including the financial implications, should be prepared by Management and presented for consideration by SDF (U) Contributors. This will require close monitoring of the SDF (U) rate in relation to the OCR rate by staff.

APPENDIX 1

CONSULTANT'S RECOMMENDATIONS APPROVED BY BOD AND CONTRIBUTORS IN MAY 2011

The following recommendations as set out in the matrix of the Management's Response (Paper BD 39/11) and approved by the BOD and Contributors in May 2011 will be effective from SDF 8.

1.1 The number of country groups should be reduced from four to three:

(a) Group 3 - BMCs which are eligible mainly for SDF (U);

(b) Group 2 - BMCs which are eligible for both SDF (U) and OCR; and

(c) Group 1 - BMCs which are eligible mainly for OCR and with limited access to SDF (U).

1.2 For the purpose of classifying countries in the respective group, per capita GDP using the UN's GDP (constant prices) data should be used as the main indicator and the following per capita income bands should apply:

Group 3	-	Below $2,000
Group 2	-	$2,001 - $10,000
Group 1	-	Above $10,000

The bands should be treated as a guide rather than rigid limits on access to SDF (U) resources and reviewed periodically to take account of inflation.

1.3 Exceptions and waivers should remain an integral part of the classification system primarily because of the flexibility they provide the Bank to quickly respond to exogenous shocks in its BMCs.

A request for waiver should be considered primarily in those instances when economic shocks or natural hazards and other vulnerabilities result in substantial economic costs, higher levels of poverty, and debt distress.

1.4 Montserrat should continue to have access to SDF (U) resources on Group 3 terms, an exception that has been in place since the mid-1990s, the primary justification for which was the continuation of periodic eruptions of the Soufriere volcano in Montserrat. These eruptions create considerable uncertainties on the island and continue to pose significant threats to economic development and long-term sustainability.

1.5 Barbados should continue to access SDF (U) resources on Group 1 terms. This is consistent with Contributors' decision since SDF (U) 5 to apply Group 1 terms and conditions to Barbados' access to SDF (U). The decision took into account considerations, including its level of development and ability to mobilise resources from other development agencies and/or the international capital market.

1.7 Exceptions should be time bound, with each approval being granted for the life of the current SDF (U) replenishment cycle, and with Contributors reserving the right to extend the exception into the next cycle.

2.1. Exchange rate adjusted Gross National Income (GNI)/GDP should be the primary indicator used in setting income limits for country groups. The use of Purchasing Power Parities (PPP) to adjust GNI/GDP could be considered once the 2012 regional PPP exercise has been completed and the results evaluated.

3.1 Reclassification resulting in a hardening of the terms and conditions should be accompanied by a background paper outlining the implications for the affected BMC(s) and involve close consultations between Government officials and Bank staff. This transition should normally not occur until two to three years following the proposed reclassification. In that case, the review exercise should take place ideally during the Mid-Term Review of the SDF (U), so that reclassification, if required, can become effective at the start of the new SDF cycle.

4.1. A dual interest rate structure should apply. All SDF (U) loans, with the exception of loans to Group 3 countries would be at a rate of 2.5% per annum (p.a.). The interest rate on new loans to Group 3 countries would be set at 2% p.a. No further change in terms and conditions is proposed. The proposed dual rates result in a simplification of the interest rate structure and avoid any increase in financing costs to BMCs.

APPENDIX 2

COMPARISON OF GROUP CLASSIFICATION PER CONSULTANT'S REPORT WITH UPDATED STATUS USING 2009 DATA

Country	GDP Per Capita (1990 prices) 3-year rolling average		GDP Per Capita (2005 prices) 3-year rolling average [2/]			
	2008[1/]	Country Group	2008	Country Group	2009	Country Group
Anguilla	11,741	1	16,670	1	15,815	1
Antigua and Barbuda	9,355	2	12,283	1	12,142	1
Bahamas, The	13,182	1	20,673	1	20,160	1
Barbados	8,749	2	12,176	1	11,957	1
Belize	3,175	2	4,056	2	4,026	2
British Virgin Islands	n.a.	1	43,196	1	43,650	1
Cayman Islands	27,617	1	53,527	1	52,639	1
Dominica	3,295	2	4,946	2	5,083	2
Grenada	3,635	2	5,440	2	5,392	2
Guyana	904	3	1,908	3	1,986	3
Haiti	247	3	430	3	433	3
Jamaica	2,291	2	4,293	2	4,239	2
Montserrat	4,543	2	7,144	2	7,368	2
St. Kitts and Nevis	6,050	2	9,448	2	9,277	2
St. Lucia	3,766	2	5,484	2	5,408	2
St. Vincent and the Grenadines	3,371	2	4,724	2	4,845	2
Trinidad and Tobago	10,235	1	14,188	1	14,411	1
Turks and Caicos Islands	16,020	1	23,705	1	26,432	1

[1/] Appendix 7 Pg 3 - Review of the Special Development Fund (Unified) Country Classification and Terms of Lending for Country Groups

[2/] UN Statistics

APPENDIX 3

COUNTRY GROUPS AND TERMS OF LENDING FOR SDF 8 COMPARED WITH SDF 7

Country	Grouping SDF 8 Compared with SDF 7	Change in the Terms of Lending
• Bahamas, The • British Virgin Islands • Cayman Islands	No Change – Group 1	**(OCR Mainly)** Interest rate - from 5% to 2.5% Maximum Grace Period - No Change Maximum Overall Maturity - from 10 to 20 Years
• Anguilla • Antigua and Barbuda • Barbados • Trinidad and Tobago • Turks and Caicos Islands	From Group 2 to Group 1	**(OCR Mainly)** Interest rate - from 4% to 2.5% Maximum Grace Period - No Change Maximum Overall Maturity - from 25 to 20 Years
• Montserrat [a/] • St. Kitts and Nevis	No Change – Group 2	**(SDF - OCR Blend)** Interest rate - from 4% to 2.5% Maximum Grace Period - No Change Maximum Overall Maturity - No Change
• Belize • Dominica • Grenada • Jamaica • St. Lucia • St. Vincent and the Grenadines	From Group 3 to Group 2	**(SDF - OCR Blend)** Interest rate - No Change Maximum Grace Period - from 10 to 5 Years Maximum Overall Maturity - from 30 to 25 Years
• Guyana • Haiti	From Group 4 to Group 3	**(SDF Mainly)** Interest rate - No Change Maximum Grace Period - No Change Maximum Overall Maturity - No Change