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RE-251

Evaluation of the IDB Emergency Lending: 1998 - 1999

Office of Evaluation and Oversight

Officially distributed to the Board of Executive Directors on September 24, 2001.

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I. Introduction

1.1 In 1998, in the context of "unanticipated" international financial turmoil, and concerned about the negative impact on the region's countries, the Board of Governors authorized the Board of Executive Directors to waive certain limitations on the lending program to permit the Bank to approve fast-disbursing lending on emergency terms for a period of one year. Originally designed to accommodate up to US$8.8 billion in emergency lending, the Bank eventually approved nine emergency loans distributed among six countries for a total dollar value of US$7.6 billion dollars (representing 39 percent of total loan approvals during the period).[1]

1.2 At the request of the Board of Executive Directors, OVE has prepared this report to present the evidence on achievements with these emergency loans to date. Because of the short time frame, no direct field research has been possible, creating primary reliance on existing Bank data sources, principally project performance monitoring reports, tranche release reports and, where available, project completion reports (PCRs).

1.3 The evaluation seeks to address four basic issues with regard to emergency lending: (i) Did the loan operations prepared under this lending modality meet the conditions established by the governors? (ii) Did the loans themselves, or the packages of which they were part, help mitigate the financial crisis in the region? (iii) Did the loans succeed in achieving the specific objectives of each individual operation? (iv) Did emergency lending have any significant impact on the Bank's other operations?

II. Background

2.1 The emerging debt market was by far the largest provider of financing to emerging markets in the 1990s. A salient feature of emerging markets at that time was a marked propensity for sharp spikes in volatility and contagion across countries during periods of crisis and resulting "closure" for emerging market issuers during those periods. An indication of contagion is the excessive co-movement of individual country returns (here measured by the average cross-country correlation of returns)?[2] As figure 1 shows, large spikes in average cross-correlation have been associated with major crises: Tequila (early 1995), attacks on the Thai baht (May 1997), the Asian crisis (October 1997), and the Russian default (September 1998).

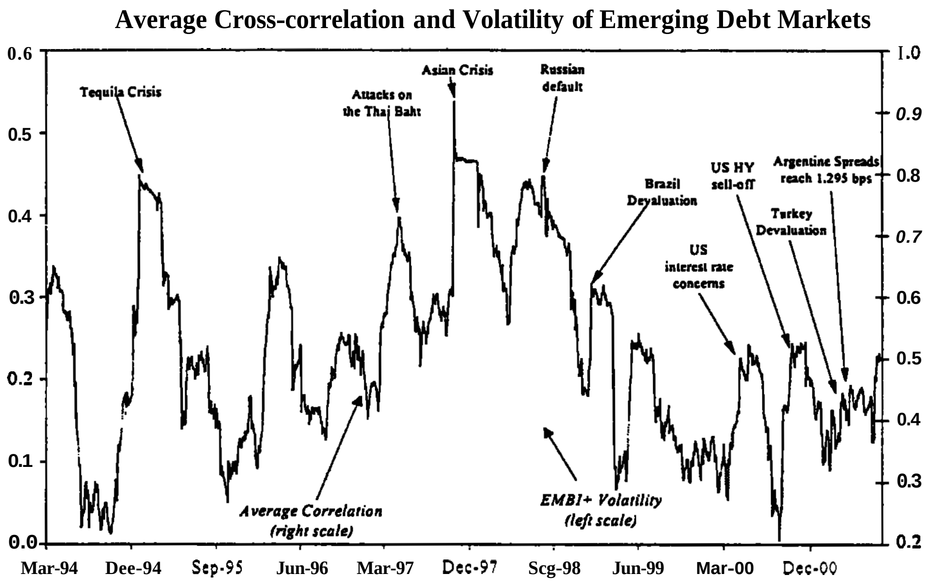
2.2 International Monetary Fund (IMF) research on these episodes concludes that "common external factors and lack of investor discrimination are the more likely explanations of spikes in observed correlations" rather than changes in fundamentals. Closure, or droughts in emerging bond markets-defined essentially as where the issuance level is less than 20 percent of the period's trend—occurred on nine occasions from March 1994 through December 2000. Market closure (drawn as shaded vertical lines in figure 2) occurred during or following periods of rapid spread

[1] There is some discrepancy in the Bank regarding the total number of emergency loan Operations approved and the total value amount of the package. On one hand, DPP includes VE0118 (Public sector and fiscal reform program), as part of the total emergency package. This was a $400 million loan approved in October 1998 divided into two components: i) $ 200 million policy-based and ii) $200 million emergency. The second component was approved but never signed. On the other hand, the LMS system reports only the policy-based component of the loan. In fact, the system only reports eight emergency loans in five countries for a total amount of $7.4 billion.

[2] The measure uses the average cross-correlation of spreads for a rolling 50-day window on the external debt of nine countries: Argentina, Brazil, Ecuador, Mexico, Peru, Poland, Russia, and Venezuela. Contagion is defined as co-movements in asset markets in excess of those that can be accounted for by movements in fundamentals. Thus estimates of contagion should ideally be asset price co-movements purged of the influence of fundamentals. However, observations on economic fundamentals are not available at similar levels of frequency (see IMF 2001a).

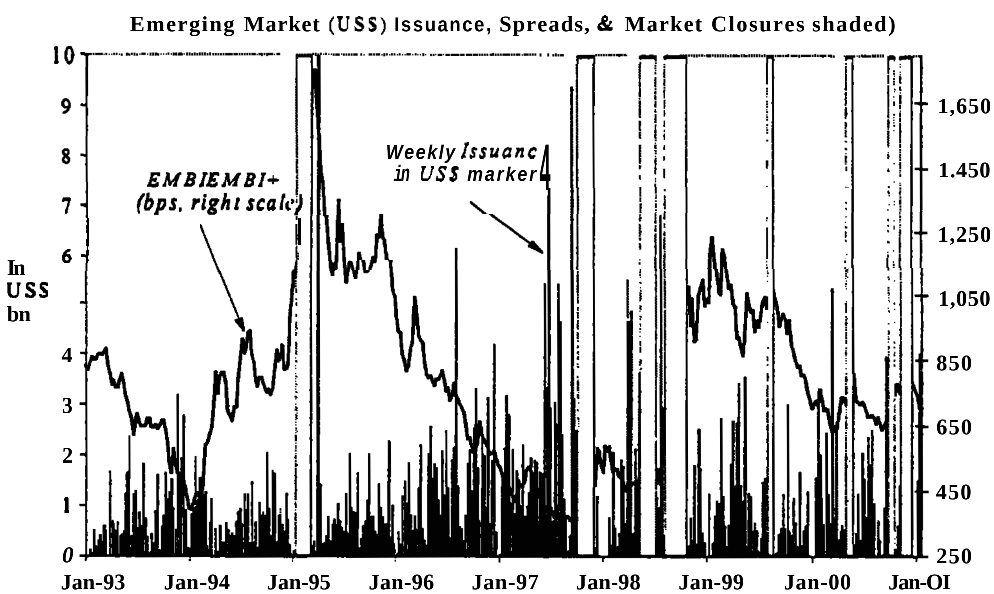
widening and market volatility. Clearly 1998 and 1999 were years of contagion and limited access to international capital markets.

Figure 1. International Emerging Market: Volatility Contagion and Closure



Source: IMF (2001b)

Figure 2



Source: IMF (2001b)

2.3 As emerging market crises have become routine, the international financial community has developed a standardized mechanism of response: the IMF-led rescue package. Packages are developed in the context of a dual crisis, that is, a currency and a foreign exchange crisis with an actual or potentially imminent banking crisis in the country. The packages' central core is an IMF program complemented by parallel and supporting operations by the World Bank, the regional development banks, and official bilateral creditors.

2.4 The fundamental objective of a rescue package is to prevent dramatic and destabilizing events, such as bank runs, currency collapses, and debt defaults. In theory, by providing liquidity, emergency packages lower investors' concerns about repayment, leading eventually to lower interest rates, less pressure on the currency, and an eventual resumption of normal economic activity.

2.5 The IDB has participated in such IMF-led emergency rescue operations since the early 1990s. Prior to that time, the IDB had no lending instrument that would readily facilitate participation in rescue operations. Investment loans were tied to physical works and disbursed on schedules tied to the completion of project components, and were thus too inflexible to serve as instruments in a rescue package. Under the IDB-7 agreement (1989), however, the Bank was granted authority to approve fast-disbursing sector loans, where disbursements were tied to the fulfillment of policy conditions and not to physical works. The Bank could use sector lending either to facilitate a prolonged process of policy change and structural reform, or to support a more dramatic and fast-paced set of reforms as part of an emergency rescue package.

2.6 Initially, IDB sector loans were modeled after the World Bank's adjustment lending instruments (table 1), and their use was limited to co-financing adjustment programs with the World Bank. Furthermore, the total lending volume of such instruments was limited to 25 percent of total cumulative approvals. The requirement of mandatory co-financing with the World Bank was relaxed in 1992, and in the IDB-8 agreement (1994), sector lending was renamed fast-disbursing policy-based lending (PBL) and limited to 15 percent of total annual approvals.

Table 1. World Bank Adjustment Instruments

Instrument	Objective
Structural adjustment loans (SALs)	Support reforms that promote growth, efficient use of resources, and sustainable balance of payments over the medium and long term.
Sector adjustment loans (SECAL)	Support policy changes and institutional reforms in a specific sector.
Programmatic structural adjustment loans (PSALs)	Consist of a multiyear framework of phased support for a medium-term government program of policy reforms and institution building. The PSAL involves a series of adjustment loans over three to five years. each building on the proceeding one(s), that provide funding for the government's medium-term reform program. The medium-term framework typically focuses on capacity and institution building in the public sector strengthening governance, budgetary processes. and efficiency of service delivery and on sustained, sequential structural and social reforms.
Special structural adjustment loans (SSALs)	Provide support for structural and social reforms to creditworthy borrowers approaching a possible crisis, or already in crisis, and with exceptional financing needs. By taking advantage of windows of opportunity for such reforms, these loans help countries prevent a crisis or, if one occurs, mitigate its adverse economic and social effects. Thus the main justification for a SSAL is the structural origin of a crisis and its mayor social consequences. The Bank and the borrower reach agreement on structural, social. and macroeconomic policy reforms. SSALs are part of an international support package.
Sub-national adjustment loans (SNALs)	Support policy changes and institutional reforms at the subnational level (provinces and states). with a focus on the subnational incentive and regulatory framework, institutional capability, and subnational expenditure programs and mitigation of social costs.

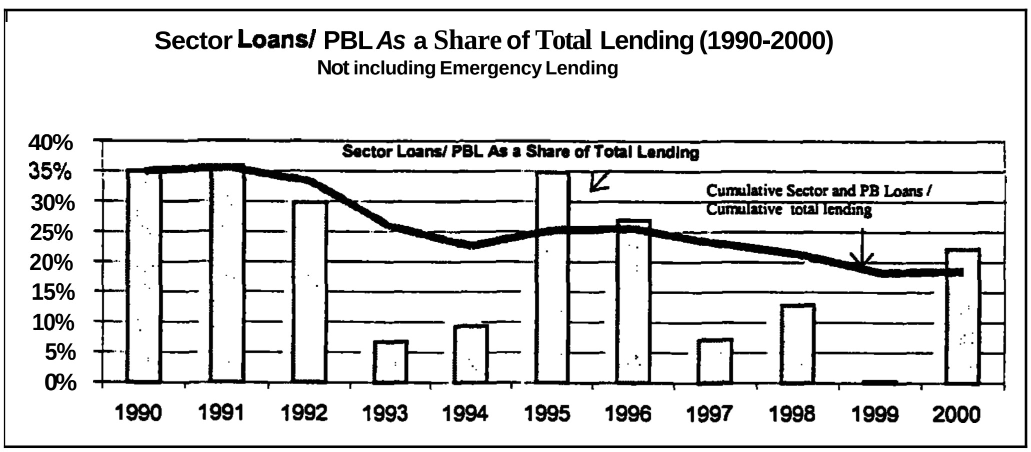
Source: Adjustment Lending Retrospective, World Bank, June 15, 2001, p.8. Note: the Table excludes debt reduction loans and rehabilitatio loans, which are also adjustment loans.

2.7 The defining feature of sector loans was disbursement against policy actions (not actual expenditures as in investment lending), and such lending was for balance of payments support in the context of macroeconomic and structural adjustment programs. Little to no attempt **was** made to determine the precise fiscal costs associated with compliance, leaving the dollar value of the loan largely independent of actual compliance costs. Instead the loans were crafted within the parameters of defined financing needs derived from consultations with the IMF and the World Bank. **As** such, these instruments became the DB's counterpart to World Bank adjustment lending (see table 1) and the IMF's Extended Fund Facility (see box 1).

2.8 While the creation **of** a PBL instrument allowed the Bank to participate in crisis-related rescue operations, this was not the only use for such an instrument. PBL was also used to support ongoing sectoral reform efforts in nonemergency contexts. Used to support long-term reform efforts, PBL operations did not necessarily disburse quickly, because of the difficult nature of many of the reforms being implemented. In fact, the IDB-8 agreement mandated a **shift** in focus for PBL from macroeconomic adjustment to reform of the state and the rebuilding of social sector infrastructure. During this process "some adjustments will be necessary to reflect the different nature and generally longer time horizon needed for effective social sector policy reform" (AB **1704**, paragraph **2.53**).[3]

2.9 The anticipated evolution of **PBL** into a slowerdisbursing instrument for public sector and social reform led to a decision to lower the ceiling on PBL **from 25** to **15** percent of total approvals. In 1995, however, the Mexican peso crisis caused balance **of** payments problems in several borrowing member countries. The Bank responded to that need by increasing **PBL** approvals well above the 15 percent limit (figure **3**).

Figure 3



Source: Bank's warehouse information system

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[3] **These** twin **objectives of rapid disbursement and strong conditionality have frequently led to tension. The balance of payments support objective Suggests either a single tranche or front-loaded tranching, with conditionality not including factors outside the control of the country's executive. The structural reform objective suggests just the opposite: multiple tranching, downstream loaded, with legal reforms requiring congressional approval and the building of consensus regarding the reforms. The latter implies** vertical **and horizontal constraints that require time to be eased.**

Box 1. IMF Instruments

The IMF lends to a borrowing member country by providing it with reserve assets in the form of widely accepted foreign currencies and SDRs obtained from other membm (except under the Poverty Reduction and **Growth** Facility). The borrower uses its **own** currency **to** "purchase" reserve assets from the IMF that are in turn, obtained **from** quota subscriptions. The **loan** is repaid by the borrower "repurchasing" its **own** currency **from** the IMF with international reserve assets. This mechanism explains why, **from** an accounting perspective. the IMF's total resources do not **vary as** a result of the IMF's financial assistance; only the composition of its assets changes. Financial assistance is typically made available in installments that are linked to the borrowing country's observance of specific economic and financial policy conditions (performance criteria or benchmarks) that must be satisfied before the next installment is released

Instrument	Objectives
Stand-By Arrangements (SBAs)	Designed to deal with any temporary balance of payments problem. The typical **SBA** is for **12-18** months and disbursement of financing is usually conditional **on** the borrower meeting specified performance requirements. **Loans** must **be** repaid within 3¼-5 years. **The** expected repayment period is shortened **to 2¼-4** ***years*** if the country's external position allows it to repay earlier
The Extended Fund Facility (EFF)	The EFF **was** established in **1974 to** provide medium-term assistance in particular to members with (a) **an** economy suffering serious payments imbalance relating to structural maladjustment in production and trade and w h m price and cost distortions have been widespread; *or* (b) an economy characterized by slow growth and an inherently weak balance of payments position that prevents pursuit of an active development policy. The length of an **EFF** arrangement is typically **3** years and disbursement is conditional *on* the **borrower** meeting specified performance requirements. including structural reforms. The facility has longer repayment periods **than** other facilities, **4½-10** years, to allow time for reforms to take effect. The expected repayment period may be shortened **to** 4½-7 years if the country's external position allows it to repay earlier.
Supplemental Reserve Facility (SRF)	**SRF** was introduced in **1997** to supplement resources made available under **SBAs** and the EFF in order to provide financial assistance for exceptional balance of payments difficulties owing to a large short-term financing need resulting **from** a sudden and disruptive **loss** of market confidence, such **as** occurred in the Mexican and Asian financial crises of **1995** and **1997.** Repayments are expected to be made within 1-1½ years but can be extended to 2-2½ **years.**
Contingent Credit Lines (CCLs)	CCLs were established in **1999 to** provide members with strong economic policies with a precautionary line of defense that **would** be readily available against balance of payments problems that might arise **from** international financial contagion. The repayment period for CCL financing is the same as for the **SRF.**
The Compensatory Financing Facility (CFF)	The CFF provides financing for members experiencing temporary export shortfalls *or* excesses in cereal import costs. Repurchases are made over **3'14** to **5** years.
Emergency Assistance	**Is** provided **to** help membm finance their recovery efforts and support economic adjustment following a natural disaster **or** conflict (see separate fact sheet for more information). Repurchases are made over **3'14 to 5 years.**
Poverty Reduction and Growth Facility (PRGF), Initiative for Heavily Indebted Poor Countries (HIPCs)	Separately, the IMF also provides concessional **or** low-interest **loans** to low-income member countries through which it provides grants to qualifying members under the **to** help reduce external debt burdens. Loans under the PRGF carry an annual interest rate of **0.5** percent, with repayments beginning 5½ years and ending 10 years **after** the disbursement.

III. Emergency Lending: Approval, Design, and Use

3.1 Bank PBL helped countries in the region weather the 1995 period of turmoil, but at the price of taking cumulative approvals under this instrument to a high of **26** percent of the total lending program by 1996, before starting to decline toward the **15** percent level set in the IDB-8 agreement?[4] However, only two years after the Tequila crisis, international financial turmoil returned. In August 1998 Argentina requested extraordinary World Bank and IDB support. At about the same time Brazil requested **similar** support fiom the international community.

3.2 Having already approved more than the authorized percentage of PBL, Bank management initiated a process of obtaining consent fiom the governors for a special program to address the new emergency. Management prepared a document **(GN-203**1-1) that laid out the **purpose** of and rationale for the new program. The document analyzed the situation as follows:

> *Countries are victims of contagion and need assistance from the international community, including the Bank, to mitigate the impact **on** general economic activity, to protect expenditures that primarily benefit the **poor** and to finance programs that consolidate and extend structural reforms (paragraph2).*

3.3 The best way to provide such support was seen as the creation of a special type of PBL, based on the argument that:

> *Where a macro-economic program and its embedded social priorities may be under threat of being undermined by a sudden reversal **or** severe drying up **of** capital flows, the Bank **will** have to deliver PBLs in rapid response mode. **In** effect, the Bank may have to adopt an emergency PBL* **as** *a variant of the standard (paragraph 6).*

3.4 Furthermore, Bank participation in such emergency lending operations needed to involve significant resource mobilization for affected countries. **This** need required action on three of the limitations on the lending program created in the IDB-8 agreement:

> *Meaningful participation by the Bank in helping countries to deal with the negative impact of the global economic crisis, would exceed the **15** per cent limit **on** fast disbursing lending and the 65 per cent indicative share for lending to A and B countries. Moreover, any supplementary investment loans would require relaxation of the matrix for investment projects under execution (paragraph IO).*

3.5 Annex 1 of the document provided a financial analysis of the Bank's capacity to mobilize resources for this program. The analysis concluded that the Bank could approve a program of as much as US$8.8 billion under terms and conditions that met the following criteria:

a) *Maintain the Bank's key financial ratios at **levels** which attest to its financial soundness in the eyes **of** the financial markets. In this regard, the reserves-to-loans ratio, which is the Bank's primary measure of capital adequacy and risk-bearing capacity,* **is** ***of*** *paramount importance;*

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[4] **Includes the policy-based components of the hybrid loans. Careful interpretation of this cumulative lending is needed since as explained before, IDB-7 (1989-1994) imposed *on* PBLs a ceiling of 25% of total approvals. IDB-8 (1994-) reduced *that* ceiling to 15%.**

b) *Ameliorate the impact **on** other borrowers **of** loan **loss** allowance requirements associated with the sharp increase in outstanding loan balances;*

c) *Discourage the use **of** emergency loans in all but exceptional circumstances: and*

d) *Preserve the Bank's capacity to undertake its projected level **of** development lending in the future (paragraph I I).*

3.6 **To meet these multiple objectives, the document proposed, and the governors approved, the following resolution:**

*(I) That for a period of one year from the date of this resolution, the Board of Executive Directors is authorized to approve emergency loans as exceptions to (a) the **15%** cap imposed **on** the amount of total resources allocated to policy based lending in accordance with paragraph **2.55** of Document AB-I **704: (b)** the indicative goal to lend **35%** of total lending to Group C and D countries in accordance with paragraph **4.5** of Document AB-I **704;** and (c) the limits **on** the percentage of total costs of any investment project which may be financed in foreign exchange by the Bank as set forth in paragraph 2.92 of Document AB-I **704;** (AB-**1959**).*

3.7 **The Board of Executive Directors was authorized to establish terms and conditions for such lending. As the World Bank had recently approved the creation of a permanent new emergency lending vehicle, special structural adjustment loans (*SSALs*), it was decided that both banks should adopt similar terms and conditions for their emergency lending. Table 2 shows the terms and conditions approved for emergency lending, as well as the standard terms and conditions for "ordinary" PBL.**

Table 2. Financial Terms of Emergency Loans

Category.	Emergency Loans	PBLs
Maturity (years)	5	20
Grace period (years)	3	5
Interest	6 month US LIBOR, reset semi-annually	OC rates reset, semi-annually
Spread	400 basis points per year	
Front-end fee	1% of the principal payable out of loan proceeds	1%
Commitment fee	0.75% , payable 60 days after signature	0.75%
Loan charge waivers	Standard waivers granted to regular OC loans do not apply \1	may apply

1 When "...the RLR recovers to its end-1997 level the Board will review the financial situation of the Bank with a view to making appropriate adjustments to the terms and conditions of emergency loans, including waivers" (IDB Quarterly Financial Management Report, March 2001).

3.8 **The following were the officially stated criteria for classifying operations as emergency loans (GN-2031-5):**

i. *An emergency loan should fit within a macroeconomic stabilization program that at a minimum, has been endorsed and will be subject to periodic surveillance by the International Monetary Fund (IMF). Where possible, the World Bank should also be finding part **of** the country's emergency program.*

ii. *The primary objective should **be** to protect the interest of the poor and sustain reform efforts to maintain or strengthen the process of social, institutional and economic reform as reflected in the conditionality of a comprehensive policy progrum; facilitate access **of** small* *and medium enterprises to credit; or protect investment expenditure **for** Bank-fnanced projects.*

iii. *The ex ante disbursementprofile should befor a period significantly shorter than traditional Bank instruments or, in the case **of** contingent loans, commit the Bank irrevocably to disburse at the discretion **of** the borrower, once conditionsprecedent have been met.*

iv. *The Ordinary Capital will be the only source for funding emergency loans. Accordingly, borrowers must be OC-eligible and shown to have the capacity to absorb theproposed loans on the special termsproposed below.*

3.9 Initially, **12** emergency **loans** were programmed in response to requests from **8** countries: Argentina, Brazil, Colombia, Ecuador, El Salvador, Jamaica, Peru, and Venezuela (table **3).** By the expiration of the program in December 1999, however, the **loans** for Ecuador and El Salvador and one of the two loans for Venezuela had not been approved. **A** second loan for Venezuela was approved, but was never signed by the government. Jamaica borrowed funds from the emergency facility to support **an** urgent program of upgrading computer systems to address the year 2000 problem. Because this activity was outside the principal purpose and focus of the emergency lending program, it will not be considered in this evaluation.

Table 3. Emergency Loans

Project number	Total Approved $m	Status	Emergency	Disbursements			Changes from original conditions
		Approval	component $m	1998	1999	2000	
AR0254	2500	16-Dec-98	2500	1020	605	380	Original FD was 21-Jan-
BR0308	2200	08-Mar-99	2200		1122	1078	Original FD was 28-Jun-
BR0310	1200	08-Mar-99	1200		525	676	
CO0202	350	16-Dec-98	350	73.5	66.5		$45 million canceled
CO0232	300	08-Dec-99	300		153		Original FD was 20-
CO0238	550	25-Jan-99	550		550		
EC0184	150	Not approved	150	N/A	N/A	N/A	
ES0131	20	Not approved	20	N/A	N/A	N/A	
JA0110	10	13-Oct-99	10			8.6	$0.84 million canceled
PE0202 [a]	311	11-Aug-99	300		236		$64.5 million canceled
VE0118 [b]	400	28-Oct-98	200	N/A	N/A	N/A	Not signed
VE0121	300	Not approved	300	N/A	N/A	N/A	

a: US $11 million corresponds to the reimbursable technical cooperation
b: See foomote 1

3.10 The Bank's emergency loans were part of a concerted international lending program. Table **4** provides the details of the financial support package assembled for each of the four countries.

Table 4. Composition of International Support			
Country& Institution	***US$ Bn***	***Planned support***	***Realized support***
ARGENTINA			
IDB	**2.5**	**S2.5** billion for Special Structural Adjustment Program ***(SSAP)*** and Strengthening of Banking System Safeguards. Funded from the Emergency Program	**2.5** billion ***SSAP*** Loan, approved December **1998.**
World Bank	**3.0**	**52.5** billion SSAL and **0.5** billion Special Repurchase Facility **Support** Loan (SRFSL)	**$2.52525** billion SSAL and **50.50505** billion SRFSL, both approved in November **1998.**
IMF	**2.8**	**52.8** billion-equivalent three-year Extended Fund Facility (EFF), dated February **4,1998**	No purchases **were** made under the EFF, which **was** replaced by a **S7.2** billion three-year Stand-By Credit in March **2000.**
BRAZIL			
IDB	**4.5**	**$1.1** billion for Global Multisector Financing Program (GMFP) **52.2** billion for Social Sector Reform and Social Protection Program (SSRSPP) **$1.2** billion for Global Credit Program (GCP) Funding **for** all project from the Emergency Program	**51.1** billion for GMFP, approved in September **1998** **S2.2** billion SSRSPP and **S1.2** billion GCP, approved in March **1999.**
World Bank	**4.5**	$1.0 billion social protection program of **two** loans **$1.5** billion social security reform program of two loans **SI.0** billion administrative reform program ***of*** two loans **51.0** billion banking reform loan	Social Security Special SECAL **(50.75757** billion), approved in January **1989** Social Protection Special SECAL **($0.25252** billion), approved in January **1989** Fiscal and Administrative Reform Special SECAL **($0.50506** billion), approved in March **2000** Second Social Security Special SECAL **($0.50506** billion), approved in March **2000.**
IMF	**18.1**	**518.1** billion three-year Stand-By Credit, December **1998**	Drawings of **54.63** billion (December **1998), 54.88** billion (April **1999) and 51.14** billion (December **1999**).
Bilaterals	**14.5**	**S13.28** billion credit facility co-ordinated by the Bank for International Settlements and backed by central banks of **19** industrialized countries; and a **51.25** billion credit facility granted by Bank of Japan	**Drawings** of **$4.54** billion in December **1998** and **$4.92** billion in April **1999.**
COLOMBIA			
IDB	**1.2**	**50.55** billion Public Finance Reform, **S0.3** billion Financial Sector Reform, and **$0.35** Electricity Sector Reform. all from the Emergency Program	**50.35** billion Electricity Sector Reform approved December **1998** **$0.55** billion Public Finance Reform approved in January **1999** **50.3** billion Financial Sector Reform approved in December **1999.**
World Bank	**0.75**	**$0.5** billion for Financial Sector Restructuring in parallel to IDB and **$0.25** billion Social Safety Net	**S0.5** billion for Financial Sector Restructuring approved in November **1999,** under SAL modality **$0.25** billion Social **Protection** Specific Investment Loans approved in August **2001.**
IMF	**2.7**	**52.7** from the Extended Fund Facility **(1999-2002)**	No purchase has been made under this **arrangement.**
PERU			
IDB	**0.3**	**50.3** Billion Financial Sector Reform II, from the Emergency Program	**50.3** Billion Financial Sector Reform approved in August **1999.**
World Bank	**0.3**	$0.3 Billion Financial Sector Reform **II** (Pension Reform)	**$0.3** Billion Financial Sector **Reform** II (Pension Reform), approved in June **1999,** under the SAL modality.
IMF	**0.51**	**50.51** from the Extended Fund Facility **(1999-2001)**	It **was** not **used** and replaced and replaced in **2001** by a **1 year** Stand-by Credit of **50.16 billion.**

ource: modified from World Ban **. (2001)**

IV. Evaluation of Emergency Lending

4.1 *An* evaluation of the Bank's emergency lending program needs to answer four fundamental questions as follows:

- Did the operations designed under the emergency program comply with the guidelines established for the use of these funds?
- Were the operations effective in meeting the general goal of the program, which was "to mitigate the impact on general economic activity" caused by financial turmoil?'
- Were the operations effective in accomplishing the various country-specific goals established in each operation?
- Did emergency lending have any significant impact on the Bank's other operations?

A. Loan Design

4.2 The first criterion that the Bank set for project design was a binding commitment that operations should be undertaken only if they "fit within a macroeconomic stabilization program that *at a minimum,* has been endorsed and will be subject to periodic surveillance by the International Monetary Fund." Argentina, Brazil, and Peru all met this condition at the time of loan approval. Colombia, which had not had a Fund program since the 1970s, did not have a formal program in place at the time of approval of the first *two* of the country's three loans. However, IDB management presented evidence to the Board that the IMF was extensively involved in the preparation of most IDB operations,[6] and that a joint memorandum had been prepared with both the Fund and the World Bank. The Board agreed that this constituted compliance with the emergency mandate.

4.3 A second condition anticipated World Bank participation, but this was not set as a requirement, merely a desirable adjunct to an emergency lending operation. Only four loans in *two* countries (Argentina and Brazil) were accompanied by emergency lending *(SSALs)* from the World Bank. In Colombia and Peru, the World Bank participated in financing the program, but did so with ordinary adjustment lending, not with emergency funds.

4.4 The third condition required that emergency loans have some explicit, country-specific purpose in addition to the general goal of mitigating the financial crisis. This condition was worded extremely broadly (see paragraph 3.7, point ii).

4.5 Given the broad wording of the mandate, assuming that a project needed to have at least one such country-specific objective is reasonable. Additional objectives were permitted, but not required. Each of the seven approved operations had a clear country-specific objective: two were explicitly focused on protecting the interests of the poor, two were explicitly focused on maintaining credit to small and medium enterprises (SMEs). No loans had an explicit focus on "protecting investment expenditure for Bank-financed projects" (see table 5 for a *summary).*

[5] Unless otherwise noted, all quoted material in this section of the report is from various project documents.
[6] The IMF endorsed IDB operations even though it did not have a formal program in Colombia.

Table 5. List of Objectives

Emergency loans	Amount (US $ billions)	1. "Fit within macroeconomic stabilization plan"		2. Primary objective:				3. "Ex ante disbursement period significantly shorter"	4. "Ordinary Capital only source of funds"
		"Endorsed by IMF and subject to Surveillance"	"Where possible, World Bank was part of the country's emergency program"	"Protect the interest of the poor"	"Strengthen social, institutional and economic reform"	"Facilitate access to credit by SMEs"	"Protect investment expenditure in Bank projects"		
AR-Special Structural Adjustment Program	2.5	Yes	Yes	Yes	Yes	Ya. partially. It included legal changer for luring and secured transactions	No	Ya (9 months) Repo Facility 60 months	Ya
BR-Social Protection	2.2	Ya	Yes	Yes	Ya	KO	No	16 months	Yes
BR-SME Financing BNDES	1.1	YCS	KO	No	No	Yes	No	18 months	Yes
CO-Electricity Sector Reform	0.35	Yes, subject to surveillance only	No	No	No	No	No	KO Nu specified in the Project Report. PPMR indicates 24 months	Yes
CO-Financial Sector Reform	0.30	Yes	Yes, but not under emergency program (regular SAL)	No	Yes	No	No	15 months	Yes
CO-Fiscal Reform	0.55	Ya	NO	No	Yes	No	No	12 months	Ya
PE- Financial Sector Reform	0.3	Yu	YCS but not under Emergency Program (regular SAL)	No	YCS	Yes	No	12 months	Yes

4.6 Because almost all operations were carried out in the context of an IMF structural reform program, it is reasonable to conclude that they all met the design criterion of "supporting efforts to maintain or strengthen the process of social, institutional and economic reform as reflected in the conditionality of a comprehensive policy program." Some operations were more strongly focused on reform, namely, Colombia's electricity reform program (CO0202) and Peru's financial sector reform (PE0202).[7]

4.7 The fourth main criterion was: "The ex ante disbursement profile should be for a period significantly shorter than traditional Bank instruments." This phrase was somewhat ambiguous, and *grew* out of the tight financial parameters within which the Bank was operating. So as not to crowd out the normal lending program, the financial projections that underlay the emergency lending program assumed that all funds would be disbursed before the end of 2000, that each individual loan would have a five-year maturity, and that all emergency loans would be fully repaid by the end of 2005. As the program was authorized to grant new approvals through the end of 1999, meeting these projections would have required faster disbursements the later in the program a loan was approved. To clarify this issue, a footnote was added to GN-2031 (starting with version 4) that indicated a target ex ante disbursement profile of 18 months.

4.8 All the proposed operations had ex ante disbursement profiles that met the 18-month standard. However, several of the loans also contained a large number of specific conditions that would need to be met before funds could be disbursed. Some of these involved the passage of legislation, a condition that often delays disbursement. The number of specific conditions ranged from a maximum of 107 to a minimum of 9, and averaged 34. Loan conditionalities were broadly

[7] This issue is taken up in section C.

shared **with** the IMF, but only three loans shared conditionality with the World **Bank,** leaving the Bank on its own to negotiate condition compliance with the country. Unlike the World Bank's SSAL program, the Bank's emergency lending instrument had no one-tranche operations, but either two or three tranches per emergency loan. Table 6 summarizes these specific design features and raises some concern about whether the ex ante project design was appropriately crafted to meet the rapid disbursement objective.

Table 6. Indicators of shortness of expected disbursements

Emergency loan	Amount (US $ billions)	Number of tranches	Number of specific conditions	Conditionality shared with IMF program	Conditionality shared with World Bank lending	Lam enacted as part of conditionality after loan approval
AR-Special Structural Adjustment Program	2.5	3	107	Yes	Yes	No
BR-Social Protection	2.2	3	60	Yes	Yes	No
BR-SME Financing BNDES	1.1	N/A [a]	No	Yes	No	No
CO-Elecmcity Sector Reform	0.35	3	9	No	No	No
CO-Financial Sector Reform	0.30	2	16	Yes	Yes, substantially	No
CO-Fiscal Reform	0.55	2	30	Yes	No	Yes (2 laws)
PE- Financial Sector Reform	0.3	2	19	Yes, substantially	No, only some minor points in capital markets (WB focused on pension system)	No

a: Disbursed against placement of resources by BNDES to SMEs following multirectoral credit regulations
b: The third tranche was a "floating" one with subtranches of US$45 million, US$60 million and US$70 million

4.9 The fourth main criterion was: "The Ordinary Capital will be the only source for funding emergency loans. Accordingly, borrowers must be OC-eligible and shown to have the capacity to absorb the proposed loans on the special terms proposed.'' All the approved loans drew upon Ordinary Capital resources, fulfilling the first **of** these conditions. Fulfillment **of** the second condition, however, is difficult to evaluate, because the phrase "shown to have the capacity" is not specific as to how this capacity is to be determined or who is to make the determination. Although the IMF routinely provides an analysis of the medium-term outlook and capacity to repay the Fund in its Article IV reports, no such analysis is contained in any of the documentation associated with the Bank's emergency lending operations. **Thus** determining whether this condition was fulfilled is impossible.

4.10 In **summary,** the seven operations approved under the **Bank's** emergency program largely met the design criteria established: almost all were undertaken as part of an IMF program, all had country-specific objectives that were broadly consistent **with** the **program's** mandate, all had short ex ante disbursement profiles, and all were funded from Ordinary Capital. Only two operations, however, were co-financed with the World Bank's SSAL, project conditionalities and tranche design appeared to be out of step with the fast-disbursement objective, and none of the plans of operation addressed the **issue of** capacity to absorb emergency lending on the special terms and conditions of the program.

B. Mitigating the Impact on General Economic Activity

4.11 The program's fundamental goal was to help countries manage the financial shocks caused by market reaction to events elsewhere in the world, particularly the Russian debt default. Possible destabilizing contagion effects included closure of international markets to new securities issuance; rising domestic interest rates and country risk premiums; speculative attacks on the currency; and loss of confidence in the domestic financial sector leading to bank runs, debt moratoria, and potential financial collapse.

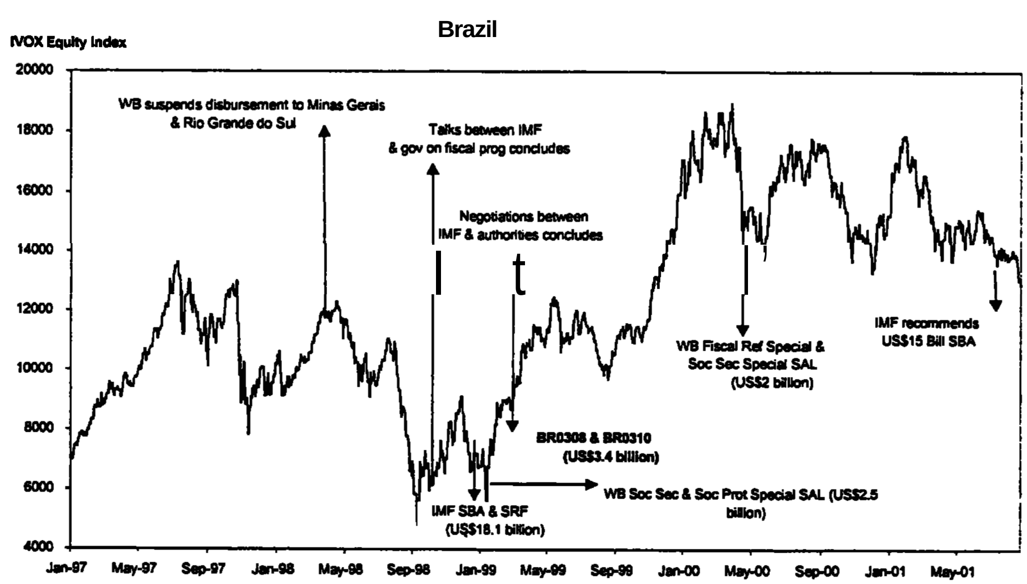
4.12 The IMF-sponsored emergency rescue package, of which IDB lending was a part, was designed to address these problems in four basic ways. First, the announcement of a concerted program of international assistance was designed to calm financial markets and reassure investors about the fundamental soundness of a country and its policies. Second, the actual provision of liquidity from international sources gave countries the resources to shore up weak financial institutions, thereby preventing a financial collapse. Third, the packages encouraged reforms that would have positive, long-term effects on economic growth. Finally, the packages often helped sustain funding for key social programs that helped maintain living standards, and thereby contributed to public support for the adjustment effort.

4.13 For those packages in which the IDB participated, there is some evidence to support each of these theoretical arguments. First, an analysis of two data series suggests that the concerted international lending did have some "announcement effect". Domestic equity markets provide the most sensitive gauge of market sentiment at home, while the Emerging Market Bond Index tracks the spread on a country's debt in international markets. A rise in the domestic value of equities and a fall in the country's spreads are indicative of improving investor confidence. If such changes coincided with the announcement (press release), this would suggest the existence of an announcement effect. However, expecting a clean coincidence between an announcement and a reversal of trends may be excessive for two reasons: the market may already have reacted if prior negotiations were credible, and unrelated events may also have affected the market.

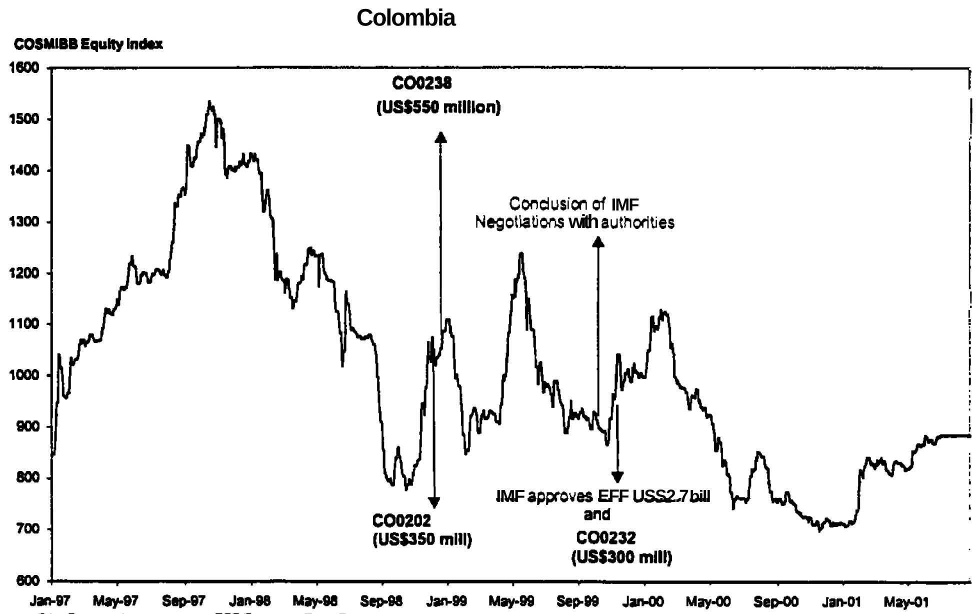
4.14 Figures 4 and 5 show data for both these series. Quite a powerful announcement effect is visible in Brazilian equity markets, and a smaller, but positive, effect is evident in Peruvian equity markets. In Argentina equity markets fell abruptly shortly after the Extended Fund Facility was approved, partly because of conflict about fiscal policy between the central and provincial governments. Finally, in the case of Colombia, determining the exact date of package announcement is difficult. Although Colombia had been in discussion with the IMF throughout 1999 and IDB projects were designed with the active support of the IMF, no formal program was announced until late 1999. During this period Colombian equity markets were volatile, and a brief rally after the IMF Extended Fund Facility announcement was followed by a continued decline in domestic equity markets.

Figure 4. Equity Index, January 1997- May 2001

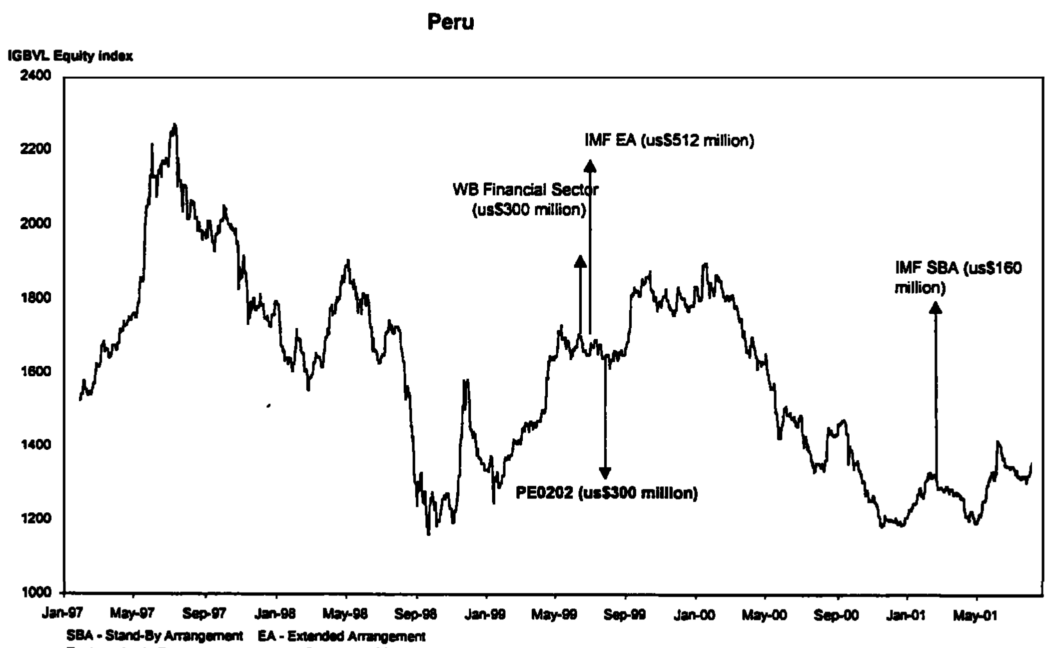
SBA - Stand-By Arrangement, SRF - Supplemental Reserve Facility, EA - Extended Arrangement,SAL - Structural Adjustment Loan
Equity index in Argentinian pesos. Lending figures in US$
Source: IDB, IMF, World Bank, and Bloomberg



SBA - Stand-By Arrangement SRF - Supplemental Reserve Facility
Equity index in reais. Lending figures in US$
Source: IDB, IMF, World Bank, and Bloomberg

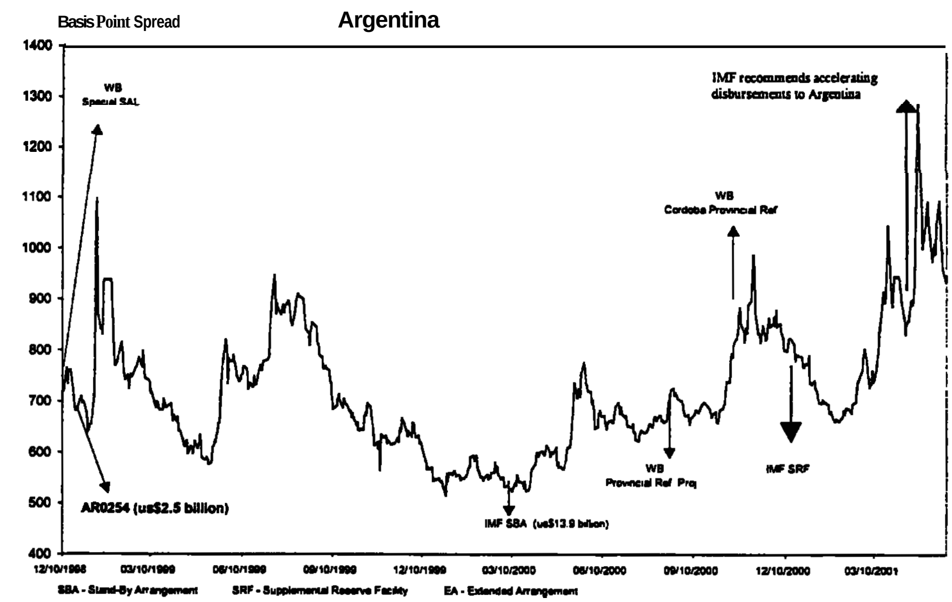


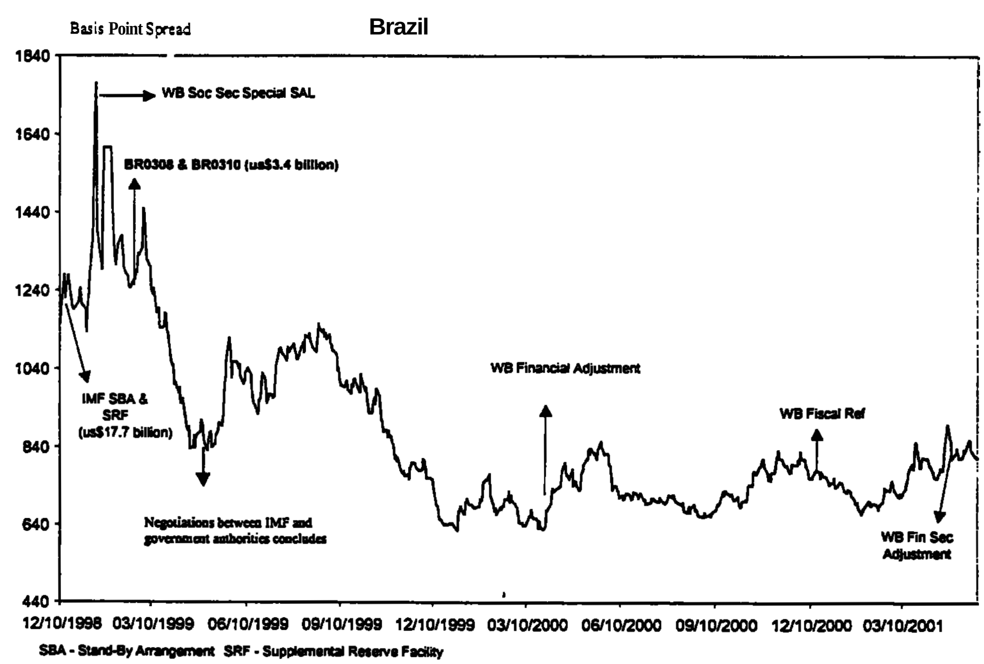
EA - Extended Arrangement EFF Extended Fund Facility
Equity index in Colombian pesos. Lending figures in US$ Source: IDB, IMF, World Bank, and Bloomberg



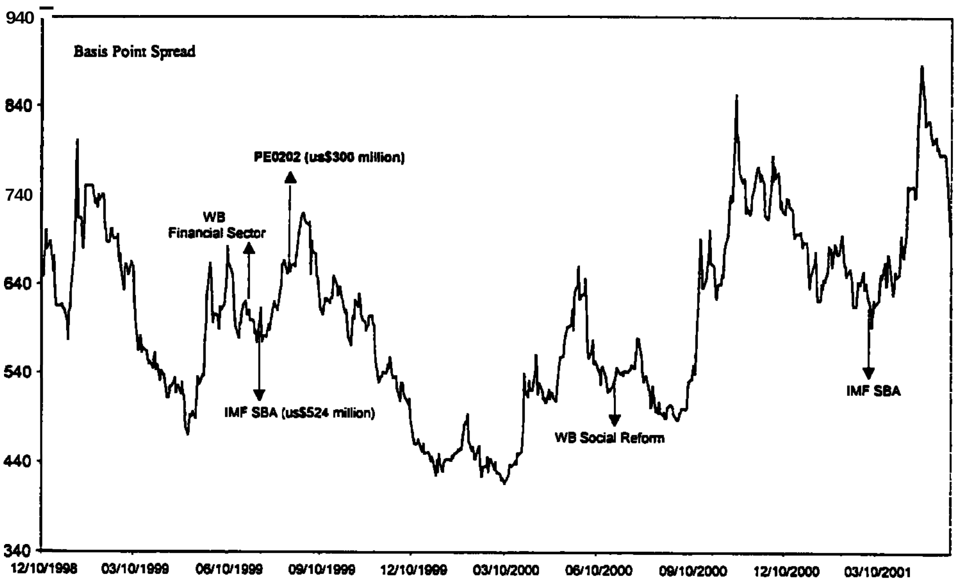
SBA - Stand-By Arrangement EA - Extended Arrangement
Equity index in Peruvian soles. Lending figures in US$
Source: IDB, IMF, World Bank, and Bloomberg

Figure 5. Emerging Market Bond Index, December 1998 – March 2001

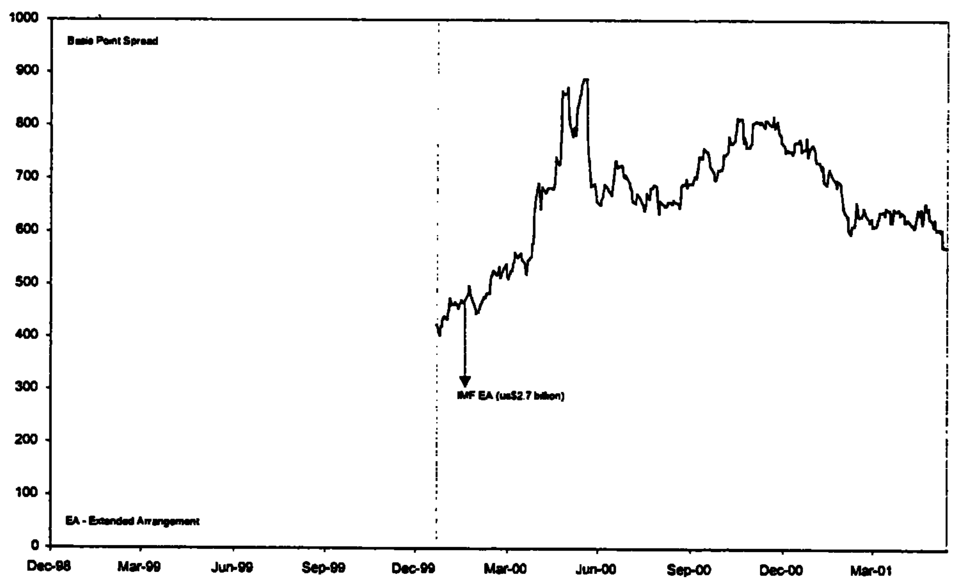




Peru



Colombia



Note Colombia was one of the few Latin American countries that did not reschedule its external debt in the 1980s and maintained an investment grade rating for sovereign debt until the last half of 1999

4.15 Figure 5 shows data from the Emerging Market Bond Index for each of the four countries. Spreads widened significantly during the early stages of the crisis, then fell substantially for Argentina, Brazil, and Peru following the packages. Colombia, in contrast, saw its risk premium increase substantially despite the package.

4.16 Both the stock market and Emerging Bond Market Index data confirm, however, that the short-term impact of a package attenuates rapidly with time. Stock markets in three of the four countries fell to levels below those prevailing before the crisis within a year of approval, as did risk premiums in the bond markets.

4.17 Further evidence regarding long-term effects comes from Standard and Poors' country outlook ratings. As a major source of credit information to financial markets, Standard and Poor's ratings provide some indication of the current view of financial markets in the countries that had used emergency lending. Only Brazil moved to a stable positive category (but shifted to negative in August 2001), Argentina and Colombia remained in the negative category, while Peru shifted to stable in 2000 (table 7).

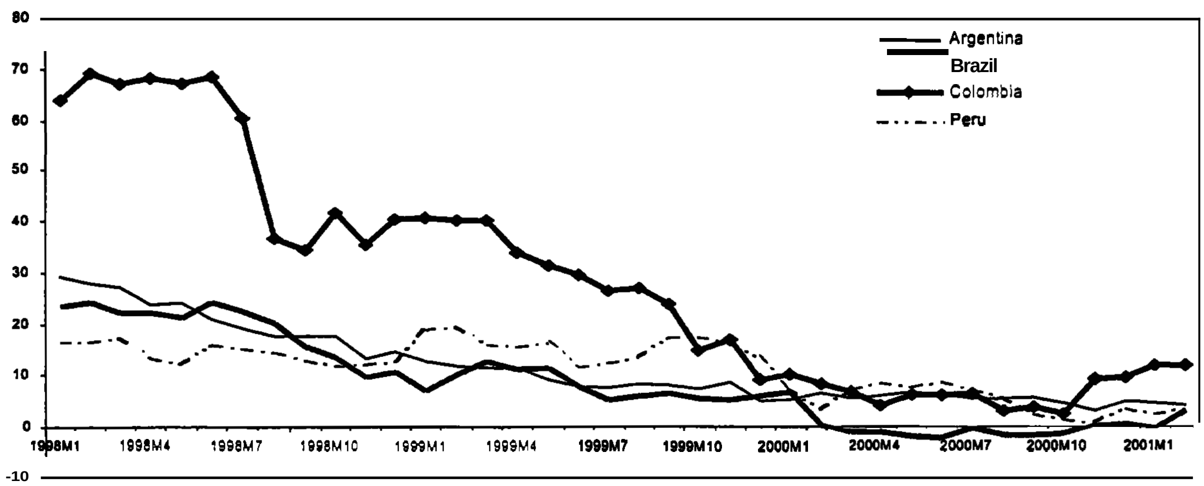
Table 7. Credit Agency Outlook Ratings Selected Months

Argentina		Brazil		Colombia		Peru	
June 6,2001	Negative	Aug. 9, 2001	Negative	May 23, 2000	Negative	Oct. 31, 2000	Stable
May 8, 2001	CW Neg.	Jan. 3, 2001	Stable	April 10, 2000	Negative	Sept. 19, 2000	Negative
March 26, 2001	CW Neg.	Feb. 29, 2000	Positive	Sept. 21, 1999	Stable	June 15, 2000	Stable
March 19, 2001	CW Neg.	Nov. 9, 1999	Stable	June 11, 1999	Negative	May 19, 2000	CW Negative
Nov. 14, 2000	Stable	Jan. 14, 1999	Negative	May 5, 1998	Stable	Dec. 18, 1997	Stable
Oct. 3 1,2000	CW-Neg.	Sept. 10, 1998	Negative	Oct. 7, 1997	Stable		
Feb. 10,2000	Stable	April 2, 1997	Stable	Aug. 24, 1995	Positive		
July 22, 1999	Negative	June 19, 1996	Positive				
April 2,1997	Stable						

Source: Standard and Poors

4.18 A major use of emergency resources was to provide liquidity to the financial system, particularly in the case of Colombia and Peru. Some evidence suggests that the countries weathered this storm better than past crises. Figure 6 shows the rate of growth in bank deposits in each of the four countries. While deposit growth fell abruptly in each country, only in Brazil did deposits actually shrink in nominal terms. All the other countries maintained a small, but positive, growth in bank deposits, a proxy indicator of a floor of confidence under the financial sector.

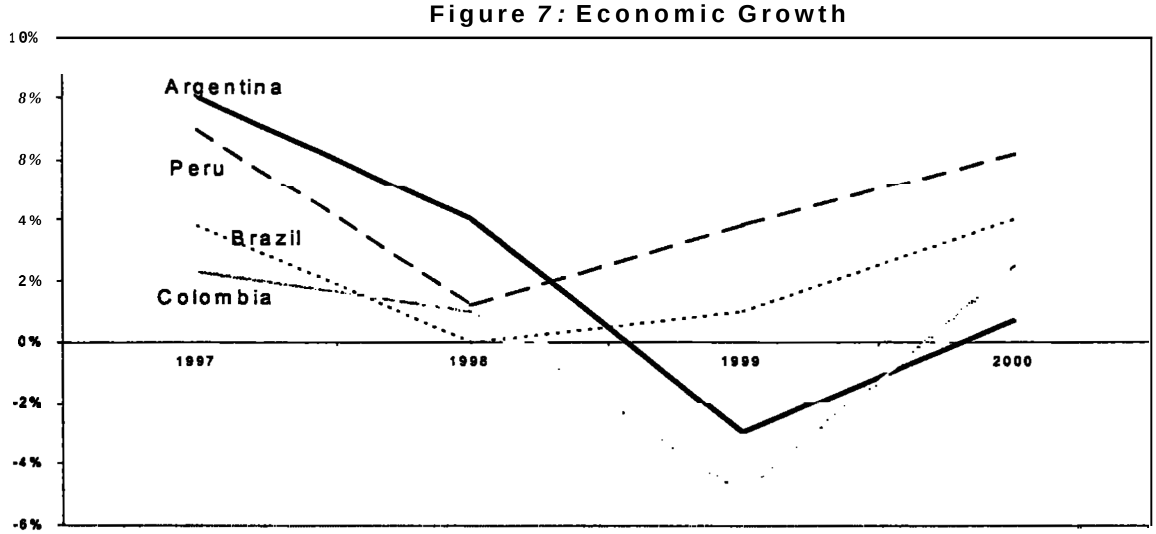
Figure 6: Change in the level of time, savings, and foreign currency deposits, January 1998– January 2001
Argentina, Brazil, Colombia and Peru 1



1/ Percentage change in the level of deposits over the preceding 12 months
Source: IMF Financial Statistics

4.19 Gross domestic product (GDP) figures also provide some evidence of mitigation. Figure 7 clearly shows that the crisis had an adverse effect on overall economic activity. However, both Brazil and Peru managed to avoid an absolute decline in GDP, while Argentina and Colombia did have negative GDP growth for a year, but then rebounded significantly.

Figure 7: Economic Growth



4.20 Finally, a major objective of emergency stabilization efforts is to prevent default. None of the countries receiving emergency assistance defaulted, an outcome to which the emergency lending packages probably made a significant contribution.

4.21 In summary, all four countries experienced significant, but short, recessions, and all resumed growth within 18 months of the onset of the crisis. The extent to which this.can be attributed to the effects of the emergency support package cannot be determined with any precision; however, the liquidity provided under the program probably contributed significantly to financial institution stabilization in Colombia and Peru, and may also have made a positive contribution in Argentina and Brazil.

C. Country-Specific Results

4.22 A third level of the evaluation explores the extent to which the individual loans achieved their stated objectives and expected outcomes. Ideally, such an evaluation tries to answer two distinct questions: Did the countries do those things asked of them in the conditionalities of the loans? Were these things an effective response to the economic and social problems they were facing? Using **a** medical analogy, the first question asks whether the patient took the medicine and the second asks whether the patient recovered.

4.23 This study, however, can only answer the first question because of the lack of time for detailed field work on each of the individual countries. Furthermore, given the size and complexity of many of the emergency operations, a full evaluation of their impact would be an expensive and time-consuming undertaking, particularly given that the countries themselves have not undertaken explicit evaluations of these operations. Thus for this part **of** the evaluation we have relied on data from the Bank's **own** documentation, particularly project performance monitoring reports (PPMRs), tranche release documents, and PCRs. Table **8** shows how the projects have been evaluated in the PPMRs, using the standard Bank criteria relating to implementation progress and probability of achieving development outcomes. With the exception of a single project in Colombia, the PPMRs rated all the projects as satisfactory in implementation and probable achievement of development objectives. Table **8** also shows, however, that PCRs are available for only a single project, even though six loans have fully disbursed and have passed the PCR due date recorded in the Bank's database.

Table 8. PPMR Ratings and PCR Status of Emergency Projects

PROJ NUMBER	APPR DATE	SIGN DATE	ORIG APPR AMT (Mill)	CURRT APPR AMT (Mill)	CANC Amt (Mill)	DISB AMT (Mill)	PPMR Ratings						PCRs	
							1998		1999		2000			
							DO	IP	DO	IP	DO	IP	Due Date	Status
AR0254	16-Dec-98	16-Dec-98	$2,500	$2,500		$2,005	P	S	P	S	P	S	Project in execution	
CO0202	16-Dec-98	19-Dec-98	$350	$350	45	$245			P	S	LP	U	Project in execution	
CO0238	25-Jan-99	19-Feb-99	$550	$550		$550			P	S			09-Mar-00	Approved
BR0308	08-Mar-99	05-Nov-99	$2,200	$2,200		$2,200			N/A	N/A	HP	HS	29-Mar-01	Pending
BR0310	08-Mar-99	28-Jul-99	$1,200	$1,200		$1,200			P	S	P	S	28-May-01	Pending
PE0202	11-Aug-99	12-Nov-99	$311	$246	$64.5	$237			P	S	P	S	30-Apr-00	Pending
CO0232	08-Dec-99	20-Dec-99	$300	$300		$300			HP	S	P	S	02-Aug-01	Pending

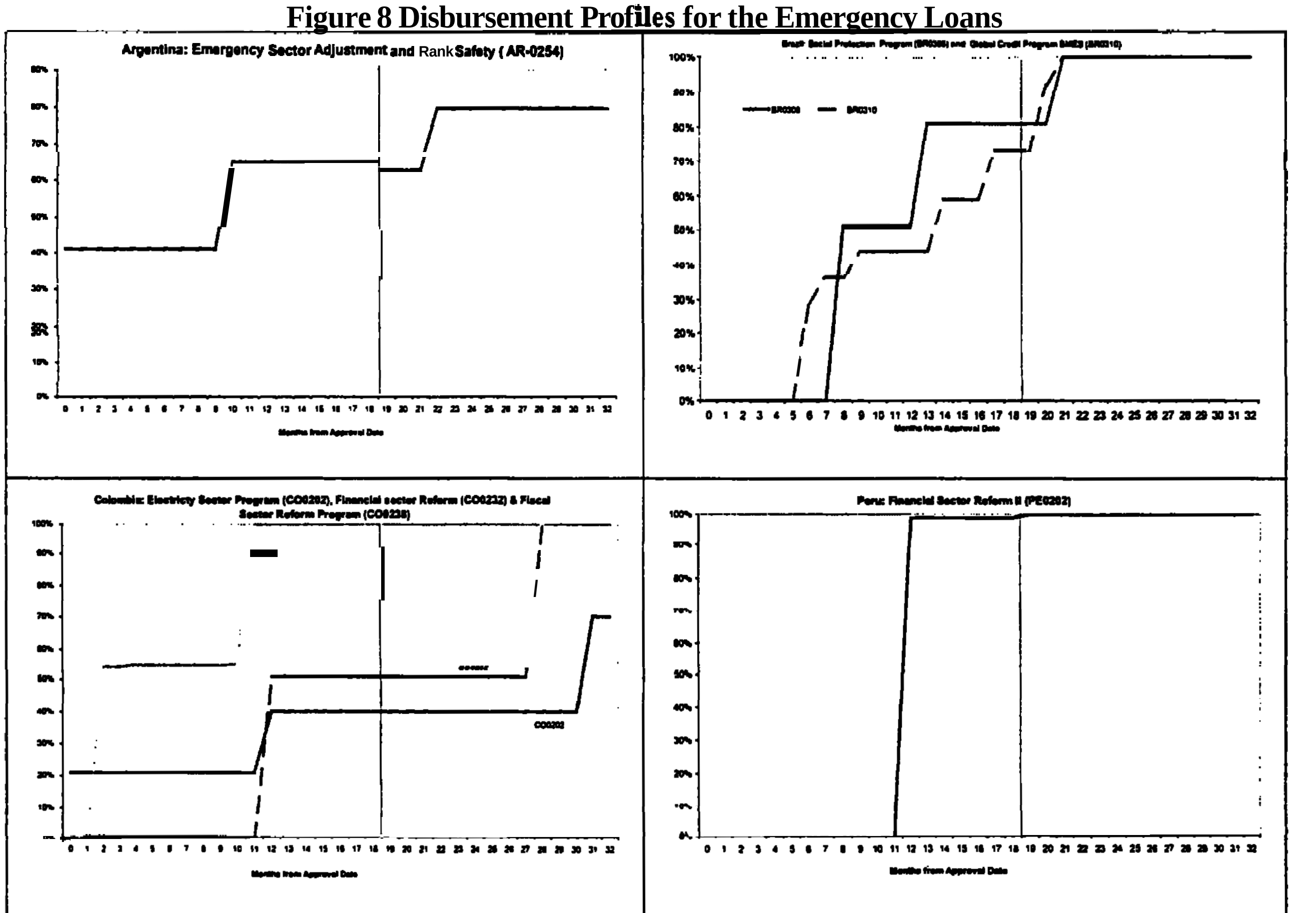
HP= Highly Probable: P = Probable; LP= Low Prob
HS= Highly Satisfactory: S= Satisfactory; U= Unsatisfactory

4.24 As noted earlier (table *5)*, the individual emergency loans varied substantially in terms of the number of objectives and conditions they incorporated. These differences contributed to significantly different disbursement experiences for the **various** emergency loans. Figure ***8*** shows the disbursement profiles of each loan and indicates that disbursement of the emergency loans followed a number of different paths. Two loans (AR0254 and CO0202) had a first tranche disbursement within days of loan signing, and CO0238 had a significant disbursement within the first weeks **of** approval. The remaining loans took some months before first disbursement.

4.25 One loan (PE0202) had what amounted to a single tranche disbursement, because the two tranches originally planned were compressed into a virtually simultaneous disbursement some 11 months after initial approval. The remaining loans show a pattern of multiple disbursements throughout the life of the project. Two of the projects in Colombia (CO0202 and CO0232) have taken a relatively long time to disburse, with CO0202 not yet fully disbursed as of the time of preparation of this evaluation. AR0254 appears to have moved in orderly tranches to the **80** percent disbursement level, where it has remained for some months. The remaining 20 percent of this loan, however, relates to a contingent credit line, the Special Repurchase Facility Support Loan (**REPO** facility).

4.26 The disbursement patterns suggest that the actual disbursement of funds from the IDB was not a time-pressured issue. Once the emergency program had been announced, countries received some relief from financial pressures and were able to take a wait and see attitude as to when (or even whether) the emergency funds needed to be disbursed. In the Argentina case, the **US$1** billion REPO program (jointly funded by the IDB and the World Bank) was explicitly designed to be disbursed only if needed, and the country's **IMF** program was also treated as a contingent line of credit, to be called upon only if circumstances warranted.

Figure 8 Disbursement Profiles for the Emergency Loans



Note: The vertical line represents 18 months from the date of approval not the contract date. The times between approval and contract dates were as follows: AR0254, zero months; BR0308, eight months; BR0310, four months; CO0202, zero months; CO0232, zero months; CO0238, one month; PE0202, three months.

Argentina

4.27 A US$2.8 billion IMF program for Argentina was approved on February 4, 1998, and the first review was completed on September 23, 1998. *On* November 10, 1998, the World Bank approved two loans forming part of the program, both under the *SSAL* facility,[8] one for US$2.5 billion to be disbursed in three tranches (two of US$1 billion each and a third of US$500 million) plus a REPO of US$505.05 million. In parallel, on December 16, 1998, the Bank approved two similar loans under the emergency program: (i) a quick-disbursing structural adjustment loan for the equivalent of **US$2** billion, and (ii) a US$500 million loan component to support the REPO facility. The conditionality matrix of these loans was part of the preventive actions agreed upon by multilateral lending agencies and the government in late 1998 within the framework of the Extended Fund Facility arrangement in effect with the IMF. Currently, 80 percent of the emergency loan package financed by the Bank has been disbursed (table 9).

Table 9: Statement of Approved Emergency Loans to Argentina

As of Aug 30th 2001 (Expressed in US$EQ)							
LOAN NUMBER	APPROVED	CANCELLED	UNDISBURSED	DISBURSED	REPAID	OUTSTANDING	INCOME[a]
AR0254	2,000,000,000			2,000,000,000		2,000,000,000	411,518,419
	500.000.000		495.000.000	5,000,000	5,000,000		11,613,831
TOTAL	2,500,000,000		495.000.000	2,005,000,000	5.000.000	2.000.000.000	423,132,249

a Represents the sum of all type of fees and interest charged to the borrower.
Source: Finance Department

4.28 The original disbursement period was nine months, ending January 21, 2000. The disbursement period was subsequently extended for another nine months to October 21, 2000. The **Bank's** loan was structured in three tranches: the first tranche of **US$1** billion was released *on* December 22, 1998, with 63 conditions; the second tranche **of** US$600 million was released on October 21, 1999, with 22 conditions; and the third tranche of US$400 million was released on October **3,** 2000, with 24 conditions (2 waivers were approved).

4.29 The general objective was "to preserve the gains achieved in ongoing reform programs in Argentina, support deeper reforms, and help assure their continuity; this includes strengthening banking system safeguards instituted by the Central Bank." In pursuit of these objectives, the loan contained 107 specific conditions (following the waiver of 2 conditions). While reviewing each **of** these in this evaluation is obviously impossible, they can be grouped into four major categories: (i) harmonization of fiscal relations between the federal and provincial governments; (ii) support of the social sectors (protection of specific social programs targeted at poverty, and including actions in education and health; (iii) financial sector reform; and (iv) regulation of utilities.

4.30 Harmonization of Fiscal Relations between the Federal and Provincial Governments. **This** loan component was designed to address the long-standing problem of large provincial fiscal deficits in the context of federal fiscal transfers. The specific objectives for this component were:

(i) streamlining and revamping of federal tax revenue share-out arrangement, to make for more effective and equitable intergovernmental transfers; and (ii) adoption of provincial taxation mechanisms to leave the provinces with more financial autonomy, and develop a less distorting and more efficient provincial tax system.

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[8] Equivalent product in term of definition and pricing as the IDB's emergency loan program.

4.31 The conditionality in relation to these objectives required that the executive branch present a proposal to the Federal Tax Commission to simplify the tax revenue-sharing system, replace the provincial gross receipts tax, and decentralize one federal tax. The executive branch did develop and present such a proposal, thereby fulfilling this condition. According to interviews with Bank personnel, this operation provided a good technical basis for a proposal to improve the current system of federal revenue-sharing transfers. The technical work carried out in connection with this loan and the dialogue established with the provinces was an important step toward the "fiscal pact," passed into law by Congress in January 2001 and ratified by the legislatures of 20 provinces.

4.32 However, actions to date have not resolved the problem: provincial deficits remain an intractable fiscal problem, and on August 29, 2001, the IDB Board approved a new Bank operation to address this issue, a regular policy-based loan for US$500 million (Support of the Federal Commitment to Growth and Fiscal Discipline, AR0280).

4.33 Support of the Social Sectors. The specific objectives in this component were to:

(i) improve poverty-measurement instruments in order to improve targeting social-safety-net programs; (ii) adopt the SISFAM [master identification system for selecting beneficiary households] method to prioritize beneficiaries in 6 additional programs; (iii) improve program evaluation by institutionalizing expenditure reviews; (iv) preserve the level of expenditure on key priority programs; and (v) expand the current unemployment insurance scheme.

4.34 According to PPMR and tranche release reports, the key achievement of this loan component was the maintenance of social spending. Spending on the targeted programs in 1999 was maintained at the 1998 level of US$680 million, and increased to US$700 million in the 2000 budget, thereby exceeding the targets established in the loan. Furthermore, the government has added three new programs totaling US$237 million whose objectives it considered similar to those of the protected programs.

4.35 Bank monitoring documents also indicate substantial compliance with detailed social sector loan conditionalities. The government made changes to improve the targeting and the quality of social services, particularly in education and health. In education, it introduced changes to improve cost recovery in the higher education system, to universalize testing in secondary schools, to expand scholarships for low-income students, to increase federal funding for education, and to expand the length of compulsory schooling fiom 7 to 10 years. In health, principal reforms included introducing competition between health providers, including union or employer-sponsored ***obras sociales,*** and strengthening the Health System Superintendency.

4.36 The principal failure of this component of the loan was the government's inability to develop a satisfactory new approach to the unemployment insurance system. This failure led to a request for a waiver of this condition, which the Bank granted.

4.37 Financial Sector Reform. **This** component aimed to:

(i) reduce distortions by greater harmonization of asset andfinancial transaction taxes; (ii) help to move forward the sale of Banco Hipotecario and expedite the sale of privatized provincial banks; (iii) strengthen the banking systems safeguards (Central Bank Repo); (iv) improve the legal framework of the insurance sector to promote competition; and (v) improve access to credit, particularly by way of lease financing and secured transactions.

4.38 The main achievements in this area are (i) the establishment of a standing interagency committee of financial sector regulators to review and improve the consistency of their regulations and practices, (ii) the sale of Banco Hipotecario, (iii) the revision of legislation and regulations governing the compulsory rating of stocks, (iv) the submission of proposed legislation to amend the legal regime for the insurance industry, and (v) the enforcement of capital adequacy requirements for insurance companies. In addition, a new leasing law was introduced, removing legal obstacles to this type of financing.

4.39 In summary, with the exception of the changes in tax distortions in different financial instruments, the specific objectives of this component were substantially achieved. The difficult pressures **of** the financial system are testing the effectiveness of the reforms implemented. For instance, in the banking sector, according to the IMF's third review of the stand-by agreement published in June 2001: "The domestic banking system remains highly liquid and solvent, although profitability indicators, such as the return on assets and the return on equity, are low by international standards, reflecting the protracted economic recession." Credit to the private sector experienced a substantial retraction during the period of program execution, falling from US$72.11 billion in 1998 to US$70.57 billion in 1999 and US$67.93 billion in 2000.

4.40 One of the most interesting features of the design of this loan was the REPO facility established to allow the Central Bank to engage in repurchase transactions with a syndicate of private commercial banks. This facility enables the Central Bank to engage in discount lending effectively without creating money, and allows it to act **as** lender of last resort without failing in its commitment to keep 100 percent of **U.S.** dollar reserves against liabilities. The government fulfilled the requirements to have disbursements executed under this facility, which it could do within a 60-month period of loan approval, but to date it has not requested any disbursements.

4.41 Public Utilities Regulatory Capacity. The specific objectives of this component were to:

(i) streamline and harmonize regulations on tariff approval and reviews, fines, capital costs, service quality, appeals of regulatory decisions, public information, among others, to enhance the efficiency of privatized utilities and improve their performance; (ii) increase accountability and transparency of regulatory agencies.

4.42 According to the tranche release reports, to achieve these objectives the government (i) submitted a bill to Congress on the harmonization of standards for regulatory agencies in the infrastructure sector; (ii) issued an opinion, through the Treasury Counsel, on the constitutionality of a rule that would obviate the requirement to hear appeals of decisions by the regulatory agencies; and (iii) submitted an action plan to increase the autonomy of federal regulatory agencies in the infrastructure sector. Thus the specific objectives of this component were achieved, and regulators now have a more appropriate framework for improving the transparency and legitimacy of their operations in this sector.

4.43 **SUMMARY.** According to the IMF, "the authorities have made further progress in the structural reform area." The IMF noted that one of the most significant measures taken was the final approval of labor market reform in May 2000, mainly because of its significant positive impact on competitiveness and employment over time. In addition, the IMF cited as a key reform one **of** the centerpieces of the health component of the IDB program in the health sector, namely, the government's issue of a decree that opened the system of health maintenance organizations to competition as of January 1,2001.

Brazil

4.44 On December **2,** 1999, the **IMF** approved Brazil's request for a three-year stand-by credit equivalent to **SDR** 13,025 million (about US$18.1 billion) in support of the government's economic and financial program. Brazil's program was also scheduled to receive bilateral support from a number of industrial countries in North America, Europe, and Asia whose governments or central banks would provide additional financing totaling approximately US$14.5 billion through the Bank for International Settlements. This additional amount was to be available over the next 12 months.

4.45 After the January 1999 devaluation, the **IMF** focused its support to Brazil in a coordinated effort with the World Bank and the Bank to supplement their actions to address macroeconomic problems, and concentrating on (i) making progress on needed structural reforms, and (ii) cushioning the severe social impacts anticipated. The World Bank was to provide US$4.5 billion and the Bank USS3.4 billion in quick-disbursing funds over 12 to 18 months. On January 7, 1999, the World Bank approved two *SSALs* as part of the program: one for US$757.6 million to support the planned social security reform, and the second for US$252.5 million to complement an IDB loan with the same name.

4.46 The DB's actions focused directly on the social consequences of the financial distress by means of two operations: a US$2.2 billion social reform and social protection program and a US$1.2 billion multisectoral credit. The rationale of the IDB support, as stated in the project documents, was to (i) protect the economic and social gains that Brazil had achieved, especially given that those likely to be hardest hit by this type of crisis are the poor, who are ill-equipped to protect themselves; (ii) protect **SMEs'** access to credit; and (iii) strengthen international markets' confidence in Brazil. Of the emergency loan package financed by the Bank in Brazil, 100 percent has been disbursed (table 10).

Table 10: Statement of Approved Emergency Loans to Brazil

As of Aug 30th 2001 (Expressed in US$EQ)							
LOAN NUMBER	APPROVED	CANCELLED	UNDISBURSED	DISBURSED	REPAID	OUTSTANDING	INCOME'
BR0308	2.200.000.000			2.200.000.000		2.200.000.000	314,569,803
BR0310	1.200.000.000			1.200.000.000		1,200,000,000	166,751,388
TOTAL	3,400,000,000			3,400,000,000		3,400,000,000	481,321,191

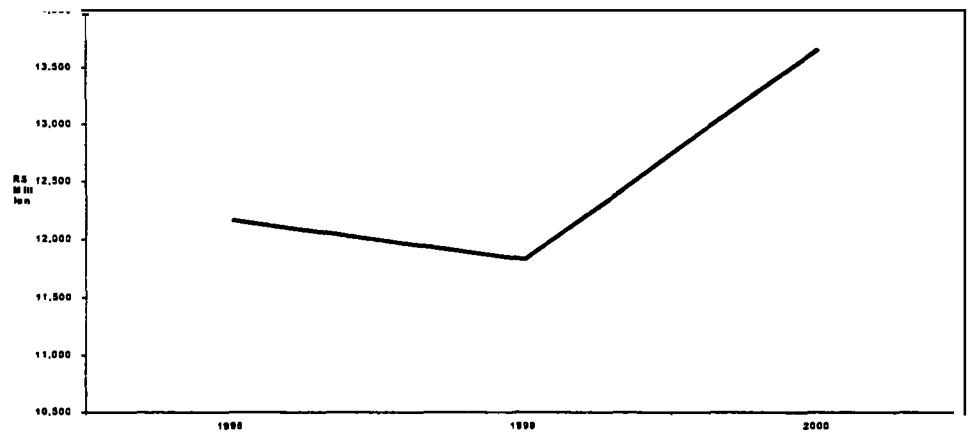
a Represents the sum of all type of fees and interest charged to the borrower.
Source: Finance Department

4.47 Global Credit **Program** for **SMEs.** This US$1.2 billion program was approved on March 8, 1999, complementing a US$1.1 billion multisectoral credit program approved in September 1998, which at that time was still in the stage of condition fulfillment prior to initial disbursement. The global credit program consisted of a discount facility for intermediary financial institutions to be provided by the Bank under the emergency loan program. The contract **was** signed ***on*** July 28, 1999, and became eligible for disbursement on August 24,200 1.

4.48 The project reports indicated that the size of the program was based on BNDES estimates of the shortfall in long-term funds for 1999 resulting from the slowing economy and the devaluation. This meant an estimated drop of more than US$1 billion flowing into the unemployment insurance scheme? The project was fully disbursed within 21 months of approval and less than 18 months of signing.

4.49 According to the PPMR, the program was classified as satisfactory. The IDB country office reported that by December 2000, 100 intermediate fmancial institutions had channeled US$948,350,000 to 9,810 operations with **SMEs,** of which 69 percent (US$649,930,000) went to 5,357 medium enterprises and 31 percent (US$298,420,000) to 4,453 small enterprises. The geographical distribution of operations was 43 percent in the southeast, 28 percent in the south, 19 percent in the northeast, 7 percent in the center-west, and 3 percent in the north. Figure **9** shows that in aggregate, **BNDES** credit to **SMEs** expanded during the period.

Figure 9: Disbursements of FINAME (SME Program of BNDES)



Source: BNDES data

4.50 The PPMR reports that credit regulations were followed without problem, and the December **2000** PPMR indicated that the program had already closed and fully disbursed. The average loan was less than US$100,000, which is approximately one-third to one-fifth the average loan size in most of the DB's other multisectoral operations, indicating adequate targeting of the program toward smaller businesses. The average loan for medium businesses was **US$12**1,323 and for small businesses was US$67,017, in both cases well below the credit regulations' maximum limit of around **US$4** million.

4.51 A PCR has not yet been prepared, although the field office indicated that it would be done in the next two months. The project report notes that "the executing agency decided not to include ex-post evaluation, since periodic in-process evaluations **of** the operation will yield sufficient information ***on*** its status and outcomes.'' **No** in-process evaluations have been received to date.

[9] **BNDES** derives about **90** percent of its funding from domestic sources, including equity. Over the past few years. about **60** percent of this total funding has come **from** two government programs, **PIS-PASEP** and the unemployment insurance scheme. derived form payroll contributions **as** mandated by Brazil's constitution. **BNDES** receives **40** percent of the unemployment insurance scheme's annual contributions **in** the form of an undated. remunerated loan. While dates for the repayment of interest on scheme funds haw been established, there arc **no** established dates for repaying the principal **sum** invested by **BNDES.** In addition, the scheme extends additional (surplus) funds to **BNDES** that arc intended for special **programs.** These funds, from the remaining **60** percent of scheme funds used by the Ministry of Labor to fund unemployment insurance. do **haw** a fixed term for repayment of principal, usually about 5 to 10 years. In 1999. these additional borrowings from the scheme accounted for **18** percent of scheme funds disbursed to **BNDES.**

4.52 Social Sector Reform and Social Protection Program. This US$2.2 billion loan was approved on March 8, 1999, the contract was signed on November 5, 1999, and it became eligible for disbursement on November 11,1999, with a disbursement period of 16 months. The program was structured in three tranches. The first tranche of US$1,122 million was released on November 11, 1999, the second tranche of US$660 million was released on April 20,2000, and the third tranche of US$418 million was released on January 17, 2001. The program included three major components: (i) providing support for the country's three-year economic and financial reform program, backing the government's goals of obtaining a fiscal surplus, while promoting even greater openness of the economy; (ii) protecting federal social spending so that the government could maintain the financing and levels of delivery of basic social services for certain priority federal programs in education, health, labor, and other social welfare sectors in 1999-2000 in an effort to minimize the social cost of the adjustment; and (iii) monitoring and support of the social reforms under way, including commitments to improve the efficiency and quality of certain social programs. The loan was accompanied by a parallel SSAL from the World Bank for US$252 million (project number P063351), approved in January 1999 and disbursed in one tranche in March 1999. The conditionality for this World Bank operation was the same as that for the IDB's first tranche.

4.53 The program supported the government's adjustment efforts after the events of January 1999. While all nonsalary items in the budget were cut by an average of 18 percent, social programs suffered only an average 8.6 percent reduction. As a result, social expenditures as a share of the budget rose from 55 to 62 percent of total expenditures.

4.54 Within the social spending category, the specific conditionality of the IDB loan was a commitment to maintain expenditure levels in 22 targeted social programs for 1999 and 2000 so as to minimize the social cost of fiscal adjustment. The tranche release reports show that the program comfortably achieved this objective. The sustainability of spending on these programs has been assured by an increase of 143 percent in the 2001 budget.

4.55 The second objective was to "support the govemment in carrying out and deepening the reforms under way in the education health, labor and social welfare sectors." The govemment undertook significant reforms in these sectors, thereby fulfilling the objective. In education, the program succeeded in deepening reforms where the Bank has been supporting Brazil with a series of programs.[10] The tranche release reports indicate that the technical contributions of these programs influenced relevant programs, like those intended to improve the quality of teachers, to enhance the quality of schools in the poorest areas, and to upgrade secondary and technical education.

4.56 In the area of health reforms, the program supported major changes in the way the govemment transferred resources to municipalities under a capitation scheme, including incentives for health prevention and promotion. In addition, technical work done allowed measuring the progress of and making adjustments to the cost-recovery mechanisms of the health care system at the local level, including implementing a user identification card on a pilot basis. The program also helped to strength the national agency in charge of regulating and supervising private health plan operators.

[10] In relation to secondary education, in March 2000 the Ministry of Education obtained a loan from the IDB to support the states' efforts to improve and expand their secondary education systems (1225/OC-BR); several states have already begun to invest counterpart resources under this program. The system for evaluating students, particularly the national secondary school examination, is being consolidated to ensure that students receive a good education. With support from the Bank-financed vocational education project (1152/OC-BR), the Ministry of Education has undertaken exemplary reform of the country's vocational education system. In a relatively short time it has completely overhauled the institutional framework for technical training and is continuing its efforts to set up a network of vocational training centers with close ties to the private sector and other employers. About 30 centers, out of a planned total of 200. were supposed to start operation in 2000.

4.57 As concerns labor markets reforms, the program supported the introduction of important measures to increase flexibility in the market, and also allowed the introduction of initiatives to increase unemployment assistance coverage during the economic adjustment process. The Ministry of Labor used the evaluation of the vocational training program as a key input for redefining its conceptual framework in this area.

4.58 Finally, in the area of social reforms, the program supported the implementation of specific measures to improve the targeting of social welfare programs financed by the National Social Welfare Fund. It also supported actions to facilitate the administrative changes in the Social Welfare Department, which resulted in better technical capacity and the decentralization of activities to the municipalities.

Colombia

4.59 To deal with the financial crisis, at the end of 1999 the Colombian government negotiated a three-year extended arrangement with the IMF for a total of US$2.7 billion. The government planned to used these funds to restore the conditions needed for the resumption of economic growth, continue to lower inflation, and achieve a sustainable external position by means of strong fiscal consolidation, financial sector restructuring, structural reforms, and a flexible exchange rate policy. Prior to the IMF's announcement of this arrangement, the IDB had approved two emergency loans (CO0202 and CO0238), and it approved a third (CO0232) immediately following the IMF announcement. Because the IDB's emergency lending guidelines required eligible projects to be developed within the context of an IMF program, the operations approved prior to the formal announcement of a Fund program were designed in close consultation with both the World Bank and the IMF.

4.60 Around 89 percent of the emergency loan package financed by the IDB in Colombia has been disbursed (table 11). The IDB signed an agreement to provide additional support to the IMF program in late 1999, whereby the IDB agreed to provide Colombia with US$1.7 billion during 2000-02, of which US$693 million (41 percent) has been approved. On the evaluation side, no ex post evaluations were planned for any of these loans and only one PCR has been submitted.

Table 11: Statement of Approved Emergency Loans to Colombia

A8 of Aug 30th 2001 (Expressed in US$EQ)							
LOAN NUMBER	APPROVED	CANCELLED	UNDISBURSED	DISBURSED	REPAID	OUTSTANDING	INCOME'
c0-0202	350,000,000	45,000,000	60,000,000	245,000,000		245,000,000	41,753,724
CO-0230	550,000,000			550,000,000		550,000,000	117,800,552
C0-0232	300,000,000			300,000,000		300,000,000	29,533,942
TOTAL	1,200,000,000	45,000,000	60,000,000	1,095,000,000		1,095,000,000	109.000.210

a Represents the sum of all type of fees and interest charged to the borrower
Source: Finance Department

4.61 Financial Sector Reform Program. This US$300 million program was signed on December 20, 1999. The program's aim was to strengthen the authorities' capacity to address the financial emergency by improving the regulatory framework and the procedures used to resolve the situation of financial institutions, improving the institutional capacity of the bodies responsible for supervising and working out the problems of financial institutions, resolving the situation in the first-tier public banking sector and in institutions under the control of or supported by the

Financial Institutions Guarantee Fund, and restructuring the financial cooperative institutions supervised by the Superintendency of Banks.

4.62 The project was fully disbursed 16 months after the contract had been signed. All components **of** the program were carried out satisfactorily according to the PPMR. The first tranche conditions had been fulfilled before the operation was submitted to the Board. These conditions included (i) amending the legal fi-amework in connection with capital adequacy standards, prompt corrective actions, and modern techniques for problem bank resolution; (ii) initiating an institutional strengthening plan at the Superintendency of Banks and at the Financial Institutions Guarantee Fund (iii) initiating a plan to expedite the resolution of the situation of public first-tier institutions; (iv) adopting a regulatory framework for cooperative financial institutions and a supervisory strategy for resolving their situation; and (v) segregating the Financial Institutions Guarantee Fund accounts to separate special emergencies (earthquake relief) from the core functions of deposit insurance and resolving troubled institutions. The second tranche conditions were also met. Its main required actions were (i) approving new regulations for the Superintendency of Banks that include explicit performance indicators for financial intermediaries to monitor solvency and financial Performance; (ii) resolving the situation (sale or consolidation, stabilization) of several banks affected by the crisis, as well as undertaking screening and action to resolve the financial cooperatives situation; and (iii) strengthening the Superintendency of Banks and improving the Financial Institutions Guarantee Fund's capacity to deal with banking crisis issues.

4.63 The Superintendency of Banks issued regulations to apply the legal framework amendments. In July 1999 the banking law was amended to strengthen prudential norms and the powers of the superintendency. Provisions included an increase in the minimum capital adequacy for financial institutions and the introduction of prompt corrective actions. In December 2000 the government issued a decree that put in place a system of explicit performance indicators for financial intennediaries, used by the Superintendency of **Banks** to monitor solvency, performance, or other problems facing financial institutions. The superintendency undertook a case-by-case screening of all **52** institutions that were eligible for formal status as financial cooperatives, of which it certified 19 as eligible. Institutions that were unable to meet capital adequacy requirements or comply with a satisfactory recovery plan were liquidated. Cooperatives that do not fall under the Superintendency of Banks are now regulated by a specialized regulatory institution.

4.64 The financial sector reform proved effective in strengthening the regulatory framework and helping resolve the situation **of** some financial institutions; however, important problems remain that need to be addressed. For example, during 1999 the Constitutional **Court** declared that the Unidad de Poder Adquisitivo Constante system, which had been in operation since 1972 to provide housing finance, was unconstitutional. In the confusion that followed, **a** large percentage **of** homeowners ceased paying their mortgages. **A** reformed readjustment **of** value unit (UR) for housing finance was introduced, but the program has turned out to be ineffective.

4.65 Public Finance Sector Reform Program. This US$550 million loan was signed on February **2,** 1999. The program was structured in two tranches with separate conditionality. Its goals **were** to assist public finance reform and help the government adopt measures to lay the groundwork for sustained improvements in the fiscal deficit and in resource allocation. The program's specific aims were to (i) remedy structural problems in the central government's finances and modemize the social security system, (ii) help regulate the responsibilities and functions of the different levels of government and improve the mechanisms now in place for intergovernmental fiscal relations, and (iii) help departments and municipalities balance their fiscal accounts.

4.66 The project was fully disbursed nine months following the contract signing. The conditionalities of the first tranche conditions were fulfilled before the operation was submitted to the Board. According to the PCR and the tranche release reports, the program made feasible the approval of remedy measures to increase the tax base, the simplification of the tax structure, the reduction of fiscal evasion, and the improved efficiency of public expenditure. In relation to the second tranche, the project also succeeded in promoting mechanisms to generate extraordinary income while downsizing the number of government personnel and public entities.

4.67 According to the PPMR, overall project execution was successful except for the subnational finances component, which was classified as unsatisfactory. The reason for this rating was the absence of tax administration reform at the subnational level, which was never presented to Congress.

4.68 While not part of the loan conditionalities, the negotiations concerning fiscal transfers never materialized. In 1999 the government proposed an amendment law to modify the distribution of transfers to departments and municipalities. The approval of this reform is part of the IMF agreements to improve fiscal relationships between the central and subnational governments. Negotiations about the amendment are still ongoing, with the latest proposal being to allow transfers to grow at an annual rate of 1.5 percent in real terms between 2002 and 2006. Starting in 2007, transfers would not be tied to current revenues, but to moving averages.

4.69 Progress in social security reform has proceeded slowly. The government proposed a new law governing pension reform, but the legislature has not acted on it. As this is a key element of the govemment's fiscal balance initiative, slow progress has contributed to continued problems in this area.

4.70 Events outside the scope of the loan have also contributed to prolonging the country's fiscal problems. Of greatest significance was a decision by the Constitutional Court to invalidate public sector wage freezes as a tool for controlling public expenditures.

4.71 As a result, the loan has not succeeded in meeting its stated objective to "assist the government in attaining its target of a consolidated fiscal deficit on the order of 2 percent of GDP in 1999; the medium-term goal was to achieve sustainable fiscal-account equilibrium." In 1999 the consolidated fiscal deficit was around 6 percent of GDP. While this fell to about 4 percent of GDP in 2000, figures for both years are significantly above the original target of 2 percent."

4.72 Electric Power Sector Program. This US$350 million loan was signed on December 19, 1998, to create an enabling environment for electric power service to be provided as economically as possible by improving the sector's efficiency. The reform program had been on both the Bank's and the country's agenda for a number of years, and it was decided that the use of an emergency lending vehicle would provide a hothouse environment for forcing through the difficult changes required.

4.73 The program's specific objectives were to improve the sector's financial sustainability, consolidate regulatory functions within the sector, define a rural energy policy in areas not connected to the grid, and promote the establishment of an institutional and regulatory system for environmental matters within the electric power sector.

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[11] The 1999 earthquake and the economic recession also thwarted the government's efforts to reach the fiscal deficit target.

4.74 Execution has been slow, with the final disbursement date extended by **24** months as of the writing of this report. In addition, the PPMR has classified progress implementation as unsatisfactory because of a lack of commitment on the part of the borrower, the political and social opposition to the program, and the lack of capacity within the executing agency. The key issue has been the privatization of electricity utilities, which has encountered significant opposition. Little progress has been achieved by the last two floating tranches, one of which has already been canceled. **This** is the only project in the Bank's entire emergency lending program that was rated as unsatisfactory on implementation progress and as having a low probability of achieving its development objectives. The anticipated benefits of linking this long-term structural reform issue to an emergency funding package have not materialized.

Peru

4.75 In August 1999 the IDB approved a loan of US$300 million for the second stage of Peru's financial reforms as part of its emergency lending program. This financing was done in parallel with a US$300 million financial sector adjustment loan from the World Bank. The World Bank loan, which was granted on a nonemergency lending basis, was approved in June 1999, with a first tranche of US$175 million and a second of USS$125 million. Disbursement was completed in October 2000. The conditionality of the World Bank loan was substantially different fiom the IDB's, and included pension reform and protection of social programs. Of the **IDB** emergency loan package, 100 percent has been disbursed, and Peru is the only one **of** the four countries that has fully repaid its loan (table 12).

Table 12: Statement of Approved Emergency Loans to Peru

As of Aug 30th 2001 (Expressed in US$EQ)							
LOAN NUMBER	APPROVED	CANCELLED	UNDISBURSED	DISBURSED	REPAID	OUTSTANDING	INCOME'
PE0202	300,000,000	64,500,000		235,500,000	235,500,000		13,119,313
TOTAL	300,000,000	64,500,000		235,500,000	235,500,000		13,119,313

a Represents the sum of all type of fees and interest charged to the borrower
Source: Finance Department

4.76 According to project reports, the **DB's** financial sector reform loan was prepared "primarily in response to destabilizing events, particularly the reduction in international private capital flows," but "in addition to immediate bank crisis resolution issues . . . the program will continue to support the strengthening and deepening of the financial sector." The general objective of the loan was to:

Strengthen the capacity of the Peruvian financial system to withstand destabilizing events, either internal or external and to further deepen and strengthen the financial system particularly in the areas of capital market development, primary and secondary mortgage development and access to low income groups to financial services.

4.77 The loan was approved on August 11, 1999, the contract was signed on November 9, 1999, and the loan became eligible for disbursement on December 15, 1999. The first tranche **of** US$147 million was released on December 16, 1999, with 8 specific conditions, and the second tranche of US$85.5 million was released on December 30, 1999, with 11 specific conditions (for which **2** waivers granted). The **sum** of US$64.5 million **fiom** the tranche was canceled at the Peruvian govemment's request.

4.78 The first specific objective was to strengthen banking supervision and regulation. The **Bank** had been working with Peruvian authorities for several years on this issue, and the government had approved a new banking law in December 1996. However, some of the provisions of that law had not been tested by a banking crisis, particularly those relating to intervention, liquidation of assets, and protection of depositors. According to the tranche release reports, the government adjusted some of these aspects of banking supervision and regulation, thereby fulfilling the conditions of the loan.

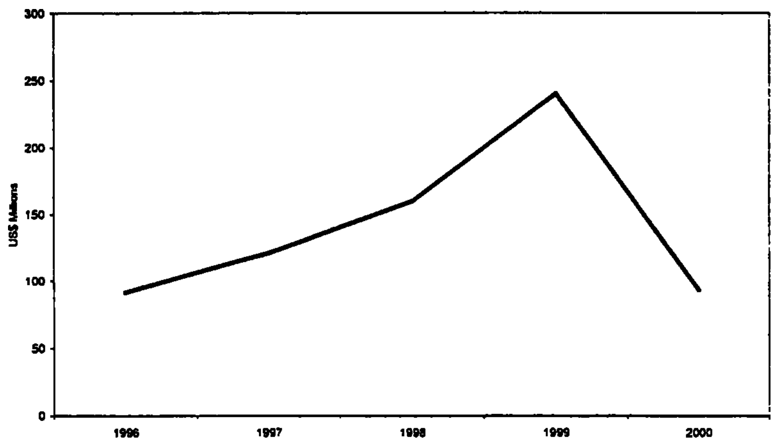
4.79 The second objective was to strengthen capital market supervision. According to the tranche release report, the program supported the introduction of adjustments in the system of capital market supervision. While making these adjustments fulfilled the conditions of the emergency loan, the effort to strengthen capital market supervision was a long-term project, which the Bank had been supporting with a technical assistance loan of US$10.9 million (1196/OC-PE). This longer-term effort has been moving slowly, however. Approved alongside the emergency loan in August 1999, as of August 2001 it was only slightly more than 15 percent disbursed.

4.80 The third specific objective was to develop a primary and secondary mortgage market. According to the tranche release report, the government did make some modifications to the institutional and regulatory framework for primary and secondary mortgage markets, thereby achieving "substantial compliance" with the conditionality. Relevant studies were carried out, but the actions needed to achieve the objective exceeded the scope of this program. The Japanese Fund for Technical Assistance financed a number of these studies (ATN/JF-662-PE).

4.81 The fourth specific objective was to strengthen microfinance institutions and improve their supervision and regulation. This was the only objective not directly related to the IMF program. A multisectoral commission was established to reduce errors in the credit reporting information system. The Superintendency of Banking undertook comprehensive on-site evaluation of 36 rural savings and loans institutions (CRACs), municipal savings and loans entities (CMACs), and SME financing companies. The program required CRACs and CMACs to develop a detailed strategy for weaning themselves from dependence on nondeposits. A study was commissioned and concluded that for the CMACs, the level of deposit mobilization and their strategy was appropriate, while for the CRACs, actions were put on hold because the government announced "an initiative to promote rural financial services" and an "active dialog with the authorities was indicated as necessary to adjust minimum capital requirements for CRACs." With regard to the legal framework for secured transactions, the program required a "workshop completed and an action plan initiated," but the government requested a waiver as the activities had not been completed.

4.82 While the various actions achieved substantial compliance with the conditions of the loan, evidence to date suggests that they have not resulted in increased credit provision to SMEs, the loan's principal substantive objective. As figure 10 demonstrates, publicly-provided wholesale credit to SMEs actually dropped significantly following approval of the loan. This is in contrast to Brazil's experience (see figure 9).

Figure 10: Credit Approvals for Small and Microenterprises in Peru by COFIDE 1996-2000



Source: COFIDE

4.83 There is no evidence that the actions carried out helped to achieve the credit provision objectives. There is no indication of any significant increase in access by low-income segments of the population to the financial sector. Note that parallel operations (grant resources) for the Ministry of Finance approved with this emergency loan have not advanced much: (i) strengthening of the Superintendency of Banks and insurance (ATN/MT-6634-PE) has only disbursed 1.4 percent **of** US$1 million; (ii) strengthening of CRACs has only disbursed 1.33 percent of US$1.5 million; and (iii) strengthening of credit union supervision (MIF/AT-276) for US$1,66 million has been canceled. In addition, the program to reduce CRACs dependence on nondeposits was a risky proposition to begin with. Encouraging deposit mobilization for weak institutions (various CRACS have failed) before adequate supervision is in place could the credibility of the financial sector deepening strategy at risk. Finally, there is no evidence that program had additional value in the legal framework for secured transactions.

4.84 The reforms were both a condition of the emergency loan and substantially accomplished; however, the proceeds **of** the Bank's lending were not necessarily used to implement these reforms. **As** is generally the case with PBL, compliance costs and loan size are not necessarily related. In the Peru case, the IMF Policy Letter noted that:

Resources borrowed abroad by the public sector are being lent to banks by the Financial Development Corporation (COFIDE), a second-tier public financial institution. This ***program, that has a US $1 billion ceiling, will provide long-term funds to the domestic banking system to permit the maturity of bank loans to be lengthened, and to provide additional liquidity to the system.***

4.85 **As** the World Bank and the IDB were the only lenders to the public sector during this period, Bank resources probably provided needed liquidity to the banking system. However, because liquidity provision was not part of the loan, Bank documents do not provide any information about the impact of liquidity provision on the banking system. **A** recent IMF (2001c) report noted, however, that COFIDE had provided net support to the banking system amounting to 0.5 percent of GDP. This was in addition to liquidity support provided by the Banco de la Nacion **(0.5** percent of GDP), as well as specific bank rescue and resale operations costing a total of 1.2 percent of GDP. These operations probably contributed materially to the stated objective **of** the loan, and may be among its major substantive accomplishments, but the lack of information in Bank documentation places this issue outside the scope of this evaluation.

Summary of Country-Specific Results

4.86 Several general points emerge fiom the review of the country-specific results of emergency lending. First, while emergency loans generally disbursed rapidly, the pace was not as fast as originally estimated. The countries regularly requested extensions, particularly for operations with difficult reform components.

4.87 Second, approved funds were not always fully disbursed. Some tranches were canceled because of countries' inability to comply with conditions, and one loan still had an undisbursed balance as of August 2001.

4.88 Third, two emergency operations were originally programmed as ordinary PBL to address ongoing reform issues (the financial sector in Peru and the electricity sector in Colombia). Both loans had problematic execution histories: both canceled at least some part of the approved loan. Peru prepaid its emergency loan within 19 months of disbursement, and Colombia is the only operation declared unlikely to achieve its development objectives by the Rank's country staff.

4.89 Fourth, the emergency loans tended to have a large number of conditions, but most of them related to such processes as conducting a study or presenting a plan. In virtually all cases, "deep" or "fundamental" conditions in Bank loans were also mirrored in the conditionalities attached to World Bank and IMF programs, making the attribution of any specific impact to IDB actions virtually impossible.

4.90 Fifth, compliance with these process conditionalities was generally high, with few waivers requested, but whether the actions taken materially improved the problems they were intended to address is hard to determine.

4.91 Sixth, the most explicit and measurable commitments contained in the loan conditionalities related to the protection of social spending. Where such conditions were included, actual performance met or exceeded expectations. With regard to maintaining credit to **SMEs,** the results were mixed.

4.92 Finally, the disconnect between loan size and implementation costs gives rise to situations in which the Bank's resources are actually being used to **support** activities different from those formally articulated in loan conditionalities. This makes it difficult to track and evaluate the impact of the Bank's program.

D. Effects on Other Bank Operations

4.93 A final element in a comprehensive evaluation of the Bank's emergency program concerns the impact of the program *on* the Bank's capacity to maintain other types of lending operations. Specifically, in approving GN-2031-5, the governors expressed concern about a possible reduction of aggregate lending levels as a result of the emergency program: "Protection of the IDB-8 mandate also requires the Bank to ensure that emergency lending would not erode its sustainable level of lending" (paragraph 10). The governors also expressed concern about the distribution of lending capacity between emergency lending and other types of lending, noting that the program should be designed **so** as to "preserve the Bank's capacity to undertake its projected level of development lending in the future" (paragraph 11).

4.94 Both of these concerns were related to the fact that the planned US$8.8 billion emergency lending program was designed to fully utilize all available Bank lending capacity. At this outer limit of the Bank's financial capacity, the various lending modalities could potentially compete for scarce financial resources. With the binding constraint being the maintenance of the Bank's reserves-to-loan ratio, three financial variables were of critical concern. The first was the pace of disbursement, because faster disbursement raises the outstanding loan balance (the denominator in the reserves-to-loan ratio) more rapidly than standard disbursement. The second was loan charges, because income from loans provides the resources for adding to reserves (the numerator in the reserves-to-loan ratio). Finally, the repayment period affected the outstanding loan balance, with faster repayments yielding reflows of principal with which new loans could be made.

4.95 The financial assumptions used to construct the emergency program anticipated a base case ordinary lending program consisting of both investment and PBL as shown in table 13. Protecting this program was possible with a one-year emergency program of no more than **US$8.8** billion, with an average disbursement period of 18 months, with **a** 5-year **maturity** on each individual loan, and with a spread of **400** basis points over LIBOR.

4.96 By the end of the one-year emergency period, however, only US$7.4 billion in emergency lending had been approved, while the 1999 and **2000** investment lending programs were each more than **US$2** billion short of initial expectations.

Table 13 Base and Actual Scenarios

(Ordinary Capital only. Expressed in millions of **US** dollars equivalent)

(Ordinary Capital only)

	1998		1999		2000		2001		2002
Category	**Base**	**Actual**	**Base**	**Actual**	**Base**	**Actual**	**Base**	**Actual*** (09/01)	**Base**
Loan approvals									
Investment loan	5,547 (90%)	5,139 (59%)	5,540 (97%)	3,050 (40%)	5,823 (85%)	3,285 (74%)	6,149 (85%)	1,069 (35%)	6,474 (85%)
Fastdisbursing loan	610 (10%)	780 (9%)	160 (3%)		1,028 (15%)	1,150 (26%)	1,085 (15%)	2,000 (65%)	1,143 (15%)
Emergency lending [1]	-	2,850 (32%)	-	4,560 (60%)					
Total	6,157	8,769	5,700	7,610	6,581	4,435	7,234	3,069	7,617
Disbursements	4,800	6,085	4,346	7,947	4,596	6,683	5,024	2,849	5,449

Note: Private sector operations are not included. Figures in parenthesis show percentages of total amount

1 **Under the emergency lending case, the table included 55.800 for 1998 and *$3,000* for 1999**

Source: Base Case from GN203 1-2. Actual from IDB information warehouse and Annual Reports

4.97 The most unexpected feature of the data in table 13 is the complete disappearance of fast-disbursing lending in 1999, with this category of lending resuming its expected size only in **2000.** Some clarification of this issue can be found by looking at the individual projects in the pipeline during **this** critical year. In June 1999 management presented to the Board a *summary* overview of the 1999 lending program (GN-2066-1) that listed the pipeline of loans in preparation (table **14).** That document provided a list **of** projects intending to use Ordinary Capital resources to **fund** regular (nonemergency) PBL. Projects were located either in category **A** (likely to be presented in 1999) or category B (may be presented in 1999). The cost of category **A** projects totaled US$700 million, with category B projects amounting to an additional US$3 15 million, a total well in excess of the program that the Bank could **support** and still carry out the **USS8.8** billion emergency lending program.

Table 14. Pipeline of loans in preparation during 1999

Project number	Project Name	Type	Category	Ordinary Capital $
ME0208	States and Municipalities Strenghten	PHIB	A	400
GU0119	Financial Sectoral Program II	PSCT	A	100
CR0135	Financial Sector Reform	PSCT	A	200
		Subtotal		700
PR0088	Agriculture/Forestry Sector Modernization--	PSCT	B	25
PE0201	Public Finance Sector Loan	PSCT	B	200
SU0015	Finance Sector Reform	PSCT	B	40
JA0049	Financial Sector Reform	PSCT	B	50
		Subtotal		315
		Total		1,015

4.98 By the end of 1999, however, none of the projects in table 14 labeled PSCT (the Bank's database nomenclature for fast-disbursing lending, a holdover fiom the IDB-7 sector lending category) had actually been approved. The only loan that was approved was the municipal strengthening loan for Mexico. This loan, for a total of US$800 million, was categorized as a hybrid, because half of the project (the US$400 million shown in table 14) was traditional investment lending and half was fast-disbursing PBL. Two other projects, PE0201 and JA0049, were subsequently approved in 2000.

4.99 Although pipeline data are not a fully reliable indicator of the Bank's future lending program, the approvals data at least suggest the possibility that crowding out of normal PBL occurred as a result of the emergency lending program, with some projects disappearing entirely and others being pushed forward into later years.[12]

4.100 Another possibility is that a perceived shortage of fast-disbursing lending authority had the effect of "crowding in" some projects into the emergency category that were not necessarily designed for emergency funding. The Colombia electricity loan and the Peru Financial Sector Reform II loan had both been under discussion as normal PBL operations for some months prior to the creation of the emergency lending program. Both have had greater execution problems than the other emergency loans, and both have cancelled at least some of the originally approved amount.

4.101 From a financial point of view, however, the real issue with respect to the 1999 lending program involves the characteristics of the Mexican hybrid loan. If the $400 million policy-based component of that loan had disbursed in the same manner as ordinary PBL, then ordinary fast disbursing lending would have exceeded the $160 million target by a wide margin.

[12] Further evidence that Bank management was trying to limit the pace of disbursement of operations can be found in several multisectoral credit operations approved around the same time as the emergency loans. Multisectoral credit loans for Chile, Peru, and Uruguay all contained new clauses, never before included in such operations, that limited the amount of the loan that could be disbursed in any given year.

4.102 Table 15 shows the disbursement profiles the Bank uses to estimate the disbursements associated with different types of lending. It shows that a typical policy-based loan is almost 90 percent disbursed at the end of four years. The US$400 million fast-disbursing portion of the hybrid loan, however, was 50 percent disbursed within a month of signing and the remainder was disbursed 13 months later, a disbursement profile much more rapid than typical PBL, and on a par with the fastest-disbursing emergency loans (see figure 8). From these data it does not appear that emergency lending put a severe constraint on the Bank's financial capacity to approve regular fast-disbursing lending.

Table 15. Typical Disbursement Profiles
(percentage of loan amount disbursed)

Year	1	2	3	4	Cumulative
Investment	1.7	8.9	14.1	14.8	39.5
PBL	32.5	31.9	19.6	4.3	88.3

Source: Review of OC Loan Charges financial projections for the period 1999-2001.

4.103 Final completion of the evaluation of this aspect of the emergency component cannot be accomplished until all the emergency loans have been paid back, because the Bank's capacity to maintain its ordinary lending program depends on the timely receipt of these reflows. The financial annex to the governors' document made this point emphatically, noting:

A maturity period of 6 years means that the Bank's planned lending program will not be affected, i.e. crowded out by the introduction of emergency loans. Under current projections, the Bank's SLL of $8 billion would be reached and unutilized lending capacity virtually exhausted in 10 years. If emergency loans were to be provided under a standard amortization period of 20 years, the Bank, as of the commencement of the emergency loan program, would need to decide immediately what part of its future lending program would be delayed or removed (paragraph 2.07).

4.104 At the moment, this issue appears to be of little concern. Repayments of emergency lending are running ahead of schedule because of Peru's prepayment of its entire emergency loan in 2000. Table 16, however, suggests that the repayment issue becomes a significant financial event only starting in 2002, when countries that borrowed on emergency terms will be called upon to make large, and unprecedented, repayments to the Bank.

Table 16 Emergency Loan Repayment Obligations

Country	2001 1st. Sem	2001 2nd. Sem	2002 1st. Sem	2002 2nd. Sem	2003 1st. Sem	2003 2nd. Sem	2004 1st. Sem	2004 2nd. Sem	Grand Total
AR	104,357,104.65	104,930,495.35	604,357,104.65	578,697,871.52	552,178,552.32	526,232,623.84			2,470,753,752.33
BR	177,407,077.91	178,381,842.09	177,407,077.91	918,381,842.09	878,794,949.19	840,733,275.53	801,908,992.24	458,038,870.95	4,431,053,927.91
CO	43,986,463.77	57,449,347.93	274,016,106.27	263,132,822.62	326,709,835.99	311,769,096.84	82,869,787.15	78,934,893.58	1,438,868,354.15
JA	235,301.43	273,967.55	272,470.46	2,273,967.55	2,217,976.37	2,164,380.53	2,109,587.03	2,054,793.48	11,602,444.40
Grand Total	325,985,947.76	341,035,652.92	1,056,052,759.29	1,762,486,503.78	1,759,901,313.87	1,680,899,376.74	886,888,366.42	539,028,558.01	8,352,278,478.79

Source: Finance Department, IDB

Excludes the following:

- 1163/OC-AR-2 (REPO $500,000,000.-)
  1135/OC-VE-2 ($200,000,000.-) due to borrower's intent not to disburse these loans
- 1195/OC-PE ($300,000,000.-) fully repaid
- 1159/OC-CO ($45,000,000.-) partial cancellation

V. Conclusions and Lessons Learned

5.1 This preliminary evaluation report on the Bank's emergency lending program has been based primarily on a review of information contained in loan documents and project monitoring reports, along with readily available data on economic and financial conditions in the borrowing member countries. The principal findings are detailed in the following paragraphs.

5.2 Bank projects were designed within the parameters of the instrument approved by the governors. All projects were located within the context of an IMF program, with the partial exception of Colombia, where the IMF was involved, but no formal program had been agreed on to by the time of approval of some IDB operations. The World Bank jointly financed projects in two of the four countries. All projects had as their principal objective at least one of the items suggested by the governors. However, none **of** the projects was accompanied by any attempt to show that the countries could bear the financial burden of the special terms and conditions established for these loans.

5.3 Financial market data provide some evidence that the announcement of an international support package including IDB participation has a calming effect on markets disoriented by contagion. The data on this point are not conclusive, however, because markets are affected by many things and the quantitative effects of concerted international lending are **small.** In any such, such calming effects are generally short-lived, and volatility in asset prices in these markets has not been eliminated.

5.4 Some evidence indicates that the activities supported by IDB emergency lending helped mitigate the effects of financial market crises both on overall output and on the resilience of the financial sector.

5.5 Emergency loans were not drawn down as rapidly as the Bank had anticipated, perhaps because positive announcement effects helped reduce the immediate need for resources.

5.6 Emergency loans had significant conditionality, much of it focused on the production of documents, studies, action plans, and reports. Almost without exception, borrowers complied with the conditionalities, and only asked for a few waivers. Because most significant conditionalities were shared with IMF and World Bank operations, determining the impact of the IDB conditionality alone is difficult. In addition, ascertaining whether the actions taken pursuant to these conditionalities were significant, or whether they had a measurable positive impact on the problems they were designed to address, is not possible.

5.7 Conditionalities focused ***on*** protecting social spending on the poor during times of crises were more than met by the borrowers, providing an important social cushion during the crisis.

5.8 Because PBL **(of** which emergency loans are a subset) does not tie disbursements to the costs of compliance with policy **reforms,** Bank resources were probably employed for purposes different from those established in the loan contract. The Bank makes no effort to track the actual uses of its funds

5.9 The emergency lending program was designed to protect the Bank's regular lending program fiom being reduced as a result of the temporary emergency program. The Bank has made considerable efforts to ensure that this condition **has** been met. In the process, it is possible, but not certain, that some crowding out of regular fast-disbursing lending occurred, particularly in 1999, the initial year of the program.

5.10 **A** final assessment of the impact of the emergency program on the rest of the **Bank's** lending can be provided only once all the emergency loans have been repaid, because the short repayment schedule was intentionally designed to protect the Bank's regular lending. Repayment of emergency loans in the next few years will require significant, and unprecedented, efforts by borrowing member countries.

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