Project Completion Report

Jamaica – Liquidity Program for Growth & Sustainability

PCR

Project Name: Liquidity Program for Growth & Sustainability

Country: Jamaica

Sector/Subsector: Private Sector

Original Project Team: Juan A. Ketterer (CMF/CCR), Navita Anganu (CMF/CJA), and Gregory Dunbar (CCB/CJA).

Project Number: JA-L1023

Loan Number: 2116/OC-JA

QRR Date: January 19, 2011

Final Approval Date of PCR: February 4, 2011

PCR Team: Juan A. Ketterer (ICF/CMF), Andrea Terán (ICF/CMF), Navita Anganu (CMF/CJA).

Acronyms and Abbreviations

BOJ	Bank of Jamaica
CAP	Clarendon Aluminum Production Limited
CITIBANK	Citibank N A
CRR	Credit Rules and Regulations
DBJ	Development Bank of Jamaica Limited
GOJ	Government of Jamaica
IDB	Inter-American Development Bank

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Annexes

I. Basic information

BASIC DATA (AMOUNTS IN US$)

PROJECT NO: JA-L1023;2116/OC-JA

TITLE: Credit Program for Growth and Development in Jamaica

Borrower: The Government of Jamaica through the Ministry of Finance & the Public Service

Executing Agency (EA): Development Bank of Jamaica Limited

Loans and TC: 2116/OC-JA

Sector: Private Sector

Lending Agent: Inter-American Development Bank (IADB)

Poverty Targeted Investment (PTI): Yes/No
Social Equity (SEQ): Yes/No
Environmental Classification: A, B, or C

Date of Board Approval: January 19, 2009

Date of Loan Contract Effectiveness: January 19, 2009

Date of Eligibility for First Disbursement: February 5, 2009

1) Months in Execution
* **From Approval**: 12 months 5 days**.**
* **From Contract Effectiveness:** 12 months

Disbursement Periods

Original Date of Final Disbursement: January 19, 2010

Date of First Disbursement: February 9, 2009

Current Date of Final Disbursement: January, 19, 2010

Disbursement Period (Months): 12 months.

Extensions: The Project was signed on January 19, 2009 with the final disbursement date being January 19, 2010 - 12 months. The Project was cancelled after the disbursement deadline came to an end since less than 50% of the resources were taken up, which was a requirement for an automatic extension.

Loan and TC Amounts
* **Original Amount:** US$300 million
* **Current Amount:** US$300 million
* **Pari Passu (if applicable):** Not applicable

Disbursements
* **Amount to date:** $95,152,177.87

Total Project Cost (Original Estimate): US$300,000,000

Redirectioning
Has this Project?
Received funds from another Project [no]
Sent funds to another Project [no]
N/A [ ]

To/From Project Number	From Sub-Loan Number	Amount

* **Current amount (adjusted for redirectioning):**

On Alert Status

Is project currently designated "on alert" by PAIS: No

If yes then why is the project on alert (DO , IP Ratings and/or relevant PAIS indicators): No

Comments on relevance of "on alert" status for this project (if applicable): Not applicable.

Summary Performance Classifications				
DO	[ ] Highly Probable (HP)	[x] Probable (P)	[ ] Low Probability (LP)	[ ] Improbable (I)
IP	[ ] Highly Satisfactory (HS)	[x] Satisfactory (S)	[ ] Unsatisfactory (US)	[ ] Very Unsatisfactory (VU)
SU	[ ] Highly Probable (HP)	[x] Probable (P)	[ ] Low Probability (LP)	[ ] Improbable (I)

II. The Project

a. Project Context

In the context of the recent international financial crisis, the IDB launched the Liquidity Program for Growth Sustainability (LPGS) attempting to support efforts of LAC countries to deal with the effects of the crisis and maintain economic growth. The specific objective of the LPGS was to maintain the flow of credit to the productive sector, partially and temporarily offsetting insufficient financing flows to the region, caused by the global financial crisis. With this instrument, the Bank aimed to support domestic production and to facilitate trade, thus protecting employment from an external and temporary shock while strengthening the macroeconomic conditions of the LAC region.

When the international financial crisis unleashed uncertainty in financial markets, a considerable reduction of normal financial flow was experienced by LAC countries. As a result of a greater restriction of credit to the region, negative effects in economic growth and employment were forecasted.

The evident reduction of financing flows manifested through a reduction in corresponding lines from international banks which limited foreign trade financing, and the reluctance of international companies to extend credit to local suppliers, at least not with the same terms and conditions that prevailed in the first semester of 2008. At the same time, larger companies found difficulties to continue accessing international capital markets, which led the biggest enterprises in LAC to demand credit in the local banking sector. In an environment with growing uncertainty and liquidity reduction, banks decreased credit to SMEs in favor of large companies financing (crowding out effect).

For the particular case of Jamaica, the external environment implied a number of risks. On the one hand, the recession in the US and Europe depressed receipts from tourism, remittances and FDI (especially in the tourism sector). However, while turbulence in the financial markets and economic downturns among its major trading partners also hurt Jamaica, the reductions in international commodity prices of imports, particularly petroleum, benefited the country. On the other hand, the international financial crisis had several effects on the domestic Jamaican financial system: there was a withdrawal of international credit lines for companies and some fall off in foreign exchange supplies from earners,1 and the value of the asset portfolio of financial institutions declined, especially those with heavy exposure to emerging market sovereign bonds, including Jamaican sovereign debt.

In this context, Jamaica faced a significant challenge to maintain an adequate flow of credit to the productive sector. Indeed, the private sector was not only suffering a generalized closure of international financial markets but also, as the financial system had almost limited capabilities to provide alternative financing as would do a lender of last resort, reduced possibilities to access domestic credit. Consequently, the efforts of the GOJ focused in facilitating alternative sources of financing that would allow for a gradual adjustment of the productive sector to the new reality of the world economy. This was especially relevant

[1] It should be noted, however, that banks headquartered in Canada, due to their conservative lending practices in the past, were relatively unaffected and were therefore still relatively willing to provide credit lines to their subsidiaries in Jamaica, which accounted for an important share of the entire market.

since the macro-economic soundness of the country and its employment level needed to be protected from this external shock.

The Bank, through the Capital Markets and Financial Institutions Division (CMF), took adequate measures to provide the support that countries needed to confront this extraordinary external shock, particularly regarding the maintenance of access to credit for the productive sector, which could have caused systemic impacts in the region. In order to endorse effort of LAC countries addressing the challenge to maintain economic growth, the Bank announced on October 13, 2008 the launch of an emergency lending program with fast disbursements of US$ 6 billion that, given the exceptional circumstances, would utilize resources available for the IDB's emergency lending facility.

Under these circumstances, the GOJ asked the Bank to set up a program under the Liquidity Program for Growth Sustainability, requesting a loan for US$ 300 million that was approved by the Board of Directors on January 14, 2009 and signed on January 19 of that same year.

b. Project Description

i. Development Objective(s)

The general objective of the Program was to contribute to the sustainable growth of Jamaica in light of the adverse impact of the financial crisis. The specific objective of the operation was to provide liquidity to maintain credit flows to the real economy, partially compensating on a temporary basis, the shortfalls in the normal credit flows caused by the financial crisis.

It is worth to note that, as mentioned above, the objective of the Program was to try to offset correspondents credit shortfall by providing credit to the banking system, via a vehicle, the DBJ, so that this credit could be on lent to productive firms. The Program did not aim to increase additional lending, but rather to keeping the flow of credit unhampered by the international money market restrictions.

ii. Components

The Program had one single component: revolving credit lines (RCLs) to make funding available to eligible intermediaries operating in the Jamaican financial system.

The loan was designed to fund a number of sub-loans to the private sector (and public sector companies, not guaranteed by the GOJ) which was having problem sourcing funds in foreign currency from their bankers to meet their overseas obligations. Specifically, the loan facility was used to:

(i) Provide working capital support (short term and medium term)
(ii) Provide trade financing support

III. Results

a. Outcomes

Achievement of Development Objectives (DO)			
Development Objective(s) (Purpose)	**Key Outcome Indicators**		
The general objective of the Program is to contribute to the sustainable growth of the country. The purpose of the operation is to provide liquidity to maintain credit flows to the real economy. **1. Outcome indicator:** AFIs have access to funding for providing credit to local businesses for short term working capital and trade, and local businesses have access to resources to finance their short term needs. Classification: **Probable**			
Planned Outcomes			**Outcomes achieved**
Baseline	Intermediate	End of Project	
1.1. 0%	1.1 No intermediate	1.1. 100%	1.1. 32%.
Reformulation: [X] N/A			
PPMR Retrofitting: **[X] N/A**			
Summary Development Objective(s) Classification (DO):			
[ ] Highly Probable (HP)	[X] Probable (P)	[ ] Low Probability (LP)	[ ] Improbable (I)
The outcome of the Program is that the full amount of the loan would have been utilized, that is, fully disbursed, but the take up was limited, resulting in disbursement of 32% of the total amount. By the end of the initial period of disbursement, (January 19, 2010), the amount disbursed was US$95,152,177.87 (as reflected in Annex II attached). However, following the original indicators and during discussions with the Government of Jamaica (GOJ), the Bank of Jamaica (BOJ), the DBJ and the Commercial Banks, this credit line met their needs since it fulfilled its role of supplying funding temporarily unavailable in the market that was needed to maintain the flow of credit to the productive sector. The general consensus was that the Program contributed to the short fall in credit brought on by the global financial crisis. Firms were able to retain and maintain their suppliers and business activities with access to the Program's resources. While the costs were somewhat high, it was comparable, and sometimes even better, at the time with what firms were able to get elsewhere.			
Country Strategy. The project and its development objective were consistent with the following Country Strategy objective of "Private sector development and macroeconomic stability". The specific objective of the operation was to provide liquidity to maintain credit flows to the real economy, partially compensating on a temporary basis the shortfalls in the normal credit flows caused by the worldwide financial crisis. This assisted in maintaining national production levels, thereby protecting employment from a temporary external shock and at the same time reinforcing macroeconomic soundness of the country.			

b. Externalities

The Program had a confidence effect which was particularly important since financial systems in LAC have traditionally suffered from episodes of generalized lack of confidence that, when combined with external shocks, resulted in massive withdrawal of deposits and capital flight. While it is not possible to quantify the impact of the LPGS program in the trust of agents in the regional financial systems during the international crisis, it is possible to affirm that it did have a positive effect in this regard, particularly in those countries which participated.

c. Outputs

<table>
<tr><th colspan="4">Implementation Progress (IP)</th></tr>
<tr><td colspan="4">1. Output: AFIs get assigned lines of credit from the DBJ
Classification: Highly Satisfactory</td></tr>
<tr><td colspan="3"><u>Planned Outputs</u></td><td rowspan="2"><u>Outputs achieved</u>

1.1 100%</td></tr>
<tr><td><u>Baseline</u>
1.1 0%</td><td><u>Annual/Intermediate</u>
1.1. No intermediate</td><td><u>End of Project</u>
1.1. 100%</td></tr>
<tr><td colspan="4">Briefly explain differences between planned and actual outputs (if applicable).
[X] N/A</td></tr>
<tr><td colspan="4">Restructuring. Indicate if this component was restructured (date of approval by Manager). Briefly discuss the consequences of these changes
[X] N/A</td></tr>
<tr><th colspan="4">Summary Implementation Progress Classification:</th></tr>
<tr><td>[x] Highly Satisfactory (HS)</td><td>[] Satisfactory (S)</td><td>[ ] Unsatisfactory (U)</td><td>[ ] Very Unsatisfactory (VU)</td></tr>
<tr><td colspan="4">The output of the Program consists of the availability of credit resources from the DBJ to the AFIs. DBJ set up the credit facility so that the AFIs had 100% of the resources available to them.</td></tr>
</table>

d. Project Costs

<table>
<tr><th colspan="4">PLANNED</th></tr>
<tr><th rowspan="2">CATEGORIES</th><th colspan="2">Source (US$)</th><th rowspan="2">TOTAL (US$)</th></tr>
<tr><th>IDB</th><th>Local</th></tr>
<tr><td>1. Component I
Credit</td><td><u>300.000.000</u></td><td></td><td><u>300.000.000</u></td></tr>
<tr><td>TOTAL (US$)</td><td>300.000.000</td><td></td><td>300.000.000</td></tr>
</table>

<table>
<tr><th colspan="4">EXECUTED</th></tr>
<tr><th rowspan="2">CATEGORIES</th><th colspan="2">Source</th><th rowspan="2">TOTAL (US$)</th></tr>
<tr><th>IDB</th><th>Local</th></tr>
<tr><td>1. Component I
Credit</td><td><u>95,152,177.87</u></td><td></td><td><u>95,152,177.87</u></td></tr>
<tr><td>TOTAL (US$)</td><td>95,152,177.87</td><td></td><td>95,152,177.87</td></tr>
</table>

IV. Project Implementation

a. Analysis of Critical Factors and Potential Risks

There were substantial risks identified during the preparation of the Program. If Jamaica were subject to several external shocks at the same time, analysis carried out as part of the Independent Macroeconomic Assessment showed that the debt to GDP ratio may rise rather than fall. Moreover, a key risk going forward was that the international financial crisis adversely affects the local financial system and confidence wanes. The Government was also dependent on rolling-over of debt in the domestic market. While it has been able to do that quite successfully to date at ostensibly negative real interest rates, a concern was that higher real interest rates were demanded or roll over risks increased.

b. Borrower/Executing Agency Performance

The Development Bank of Jamaica (DBJ)[3], a wholly owned government institution regularly acts as a second tier vehicle for Government sponsored credit programs.

DBJ was identified by the Government as the second tier institution to administer this operation. As a result, DBJ identified a number of its key staff (head of the AFI relationships, head of accounting and legal) to administer the operation with the support of one full time analyst. The bank's primary function is to provide development credit through medium and long term financing. This process is conducted in a timely and cost effective manner at competitive interest rates through the AFIs to the sub-borrowers.

Borrower/Executing Agency			
[ ] Highly Satisfactory (HS)	[X] Satisfactory (S)	[ ] Unsatisfactory (U)	[ ] Very Unsatisfactory (VU)

V. Sustainability

Given the characteristics and temporary nature of the Program and the fact that sustainability was not an objective of the Program, no sustainability analysis is required. However, some sort of sustainability of the Program derives from the fact that the Jamaican financial system was able to overcome the effects of the financial crisis, it remains sound and stable and continues to provide financing resources to the productive sector.

Sustainability Classification:			
[ ] Highly Probable (HP)	[X] Probable (P)	[ ] Low Probability (LP)	[ ] Improbable (I)

VI. Monitoring and Evaluation

DBJ was responsible for the following monitoring and evaluation activities during the life of the program:

[3] DBJ is a merger of the Agriculture Credit Bank of Jamaica Limited (ACB) and the National Development Bank of Jamaica Limited (NDB) on April 1, 2000. In September 2006 the Government further merged the operations of the DBJ with that of the National Investment Bank of Jamaica Limited (NIBJ). This merger was in response to Governments commitment to effect certain efficiencies in the public sector. Its aim is to assist in the development and modernization of all viable enterprise in the agriculture, agro-industrial, information technology, manufacturing and tourism sectors of the Jamaican economy.

- Ensure the nominal value of the securities received from the AFIs was at least 110% of the amount outstanding.
- Ensure that in the case of the electronic securities, the pledged collateral was transferred to their account at the central bank (BOJ).
- In relation to physical securities, DBJ held these securities together with a properly executed form of transfer and notify the issuer of these instruments, of their interest in them.
- Provide the AFIs with quarterly reports and statements showing the amount due for interest payment.
- Provide IDB with quarterly reports showing amounts taken up, the sub-borrowers and their type of operation.
- Monitor compliance with IDB's environmental and social safeguards and policies.
- In collaboration with the AFIs, and the IDB, plan site visits to the operation of sub-borrowers to ensure that the resources were spent on productive activities.

Both IDB and DBJ were out in the field monitoring the Program, and visits were made to both the AFIs and the sub-borrowers. DBJ provided both site visits and financial reports while IDB through an independent consultant and the local country office visited the AFIs and sub-borrowers and compiled their own independent reports.

During the period, site visits were made to twenty (20) sub-borrowers and several visits to the AFIs.

The purpose of the visits to the AFIs was chiefly:

- to ascertain if they had any issues accessing the Program;
- to confirm the authenticity of the information provided to the DBJ for disbursements were in fact accurate; and
- to verify that appropriate securities are being held for the requisite loans to the sub borrowers.

The site visits to the sub-borrowers had the following objectives:

- to confirm the authenticity of the information provided to the AFIs;
- to ensure the funds were used for the intended purposes; and
- to hear from the real sectors, what were the issues affecting them in accessing the funds of the loan program.

The sub-borrowers visited covered various types of operation as indicated below.

Of the eleven manufacturing companies visited, 55% of them export their finished goods to other Caribbean Islands and markets in the USA, hence earn foreign currency.

All sub borrowers were found in compliance with the CRR and with the purpose of the loan proceeds. There were no instances of fraudulent activities observed from the sample of firms visited even though some of them were among the higher risks ones in the portfolio.

The companies expressed their appreciation for the line of credit but criticized some AFI's for not marketing it enough and also in taking too long in approving the loans.

a. Information on Results

Overall, seventy seven firms benefitted from the line, with the majority (31%) being in the manufacturing sector, followed by tourism. Sixty six of seventy seven firms used the line for working capital needs, maintaining their business operations.

Below, Table II shows the number of sub-borrowers (77) who participated in the project by banks, by sector, by loan purpose, and amount.

Table II- Analysis of Loans by Banks, Sector, Number of Borrowers (%) & Purpose of Loan

BANKS (AFIs)	Number of Borrowers	Amount – US$	Borrowers by Sector	Number of Borrowers	% Borrowers	Purpose of Loan	Number of Borrowers
Bank A	44	23,000,000	Manufacturing	24	31.2%	Working Capital	66
Bank B	11	23,083,937	Tourism	11	14.3%	Trade Financing	11
Bank C	16	45,816,439	Service	11	14.3%		
Bank D	6	3,251,802.87	Mining	1	1.3%		
			Agro-Processing	15	19.5%		
			Distribution	7	9.1%		
			Construction	4	5.2%		
			Energy	2	2.6%		
			Other	2	2.6%		
Total	77	95,152,177.87		77	100%		77

This line of credit assisted in maintaining national production levels, thereby protecting employment from a temporary external shock and at the same time contributed to reinforcing the macro-economic soundness of the country.

b. Future Monitoring and Ex-Post Evaluation

The IDB country office in Jamaica will continue to monitor the program with regards to the retention of value of the securities and for the repayment of the loan amounts.

Further, two evaluations appear on the loan contract as follows:

(i) At the end of two (2) years from the date of signature of this Contract, an intermediate evaluation report on the results of the Program (that is January 19, 2011); and

(ii) At the end of sixty (60) days after the date of payment of the final amortization of the Financing, a final evaluation report on the results of the Program,

These evaluations were to assess the compliance with the objectives of the Program and its impact taking as benchmarks the parameters established in the Results Matrix. Those reports are embedded in the present Project Completion Report; therefore they will not be shown in a separate document.

VII. Lessons Learned

The lessons learnt during project execution were as follows:

Credit risk. One of the objectives of the operation was to minimize the risk that the GOJ would worsen its debt position in the event that something went wrong. In this context, the main risk factor resided on the possibility that one (or more) of the financial intermediaries (AFI) had a credit event and failed to repay its loans to the DBJ. Indeed, such situation was not a remote one given the crisis environment. To hedge that risk, all loans granted by the DBJ were required to be fully collateralized with government debt, so that in the event of default the GOJ would change creditors from debt holders to the IDB.

Sizing. The second lesson has to do with the procedure to size the Program. The sizing of the program was estimated by an analysis conducted with the collaboration of the GOJ, the BOJ, and the Commercial Banks. The final assessment of the size of the Program was based on three main considerations: (i) Estimated Financing Gap, given the outstanding short term liabilities in foreign currency of commercial banks, the expected reduction in external sources of financing, the underutilization factor of existing lines, and the probability of a decrease in economic activity resulting in an additional decrease in demand for foreign liabilities; (ii) Demand of potential participating banks revealed during the Mission in November 2008; and (iii) the DBJ Operational Capacity.

Given the urgency of the situation, it seemed a reasonable methodology at that time. Although a quantitative analysis on historical data and simulations could have been interesting, and presumably more accurate in estimating the demand, the marginal costs of the simulations outweighed its benefits for the preparation of the Program. In addition to that, all demand driven programs are subject to the limitation that if the demand changes the demand of the program funds might change as well.

Key elements of the Program's design. The design of the Program was crucial to generate the right incentives:

- As it was an emergency line, it was expected that the Program would only be used in exceptional market situations. With the return of more normal market conditions, it was expected that the use of the line would be reduced. In this sense, the high costs of the resources were consistent with the character of the product and that strengthened the incentives to use the resources only for and during an emergency situation.
- Injecting financial resources into a system where there was high uncertainty and limited information on actual conditions of intermediaries created significant risks for both the Executing Agency and the Bank. The structuring of guarantees (mainly GOJ bonds, with over collateral) reduced these risks substantially and strengthened the incentives for resources to be used only for the purposes defined in the Program.
- The quick reaction of the Bank was vital to respond to the countries' need with a product that was made available efficiently. While in some cases countries agreed that the availability of resources was enough to reduce market uncertainty and slow the decline of private sector credit, in other cases (such as Jamaica) actual disbursements of resources were needed, although not in the full amount it was originally estimated. Nevertheless, it could also be important to consider the possibility of designing contingent instruments for emergencies that do not necessarily require the disbursement of resources as it was aimed by the design of the LPGS.
- The availability of the LPGS for a limited period of time, both in terms of access to the product and the disbursement period, proved to be appropriate since it was consistent with the temporary emergency feature of the product and allowed for an efficient use of the Bank's lending capacity.

The Office of Evaluation and Oversight (OVE) prepared some evaluability notes to the LPGS projects, which are addressed in Annex I.

VIII. Other Comments

Risk analysis. Regarding the analysis of the risks of the Program, having had the opportunity to go through a quantitative analysis would have improved the risk analysis of the Program. However, during the preparation of the Program choices had to be made given the urgency of the situation.

In terms of the development impact of the Program, there is always a concern about a substitution effect. However, such an effect is quite difficult to control for, or even to observe. In this regard, the elaboration of an outcome indicator such as unmet loan demand could not be successfully achieved given the methodological challenges to calculate a variable of this nature.

Opportunity and timing of the LPGS. The LPGS was made available to the region when the international crisis was having a greater impact in the availability of external financing towards the region, there was an uncertain environment regarding the extent and length of the crisis and its potential effects in the region. The LPGS program was the first of its type among the multilateral institutions, who did not adapted existing facilities or implemented new ones specially tailored to mitigate effects of the international financial crisis in its member countries until the end of the first quarter of 2009.

Access to the LPGS. The simplicity of the design of the LPGS facilitated expedited access of countries to the LPGS, which in turned allowed monetary authorities to complement their policy actions at the national level to mitigate the immediate consequence of the international crisis by providing confidence to market agents regarding the capacity of the financial systems to overcome the effects on their liquidity.

Loosening of the Effects of the Crisis. The effects of the international crisis on external funding began to show signs of moderation in 2009, particularly since the second quarter when there were signs of a stabilization of the sources of external financing to the LAC region. This explains the fact that some of the countries that had requested a LPGS program did not use all the resources made available by the Bank's approved loans. It was actually a sign that the main reason for requesting the program was having an emergency instrument if the effects of the crisis on the access to external financing deepened. Jamaica was not an exception, fortunately, and the line needed not to be fully disbursed. In this regard, it should be noted that the LPGS was perceived as an emergency instrument (or instrument of last resort), both by the authorities of Jamaica and also by the IFIs.

IX. Current Situation of the Financial System in Jamaica

Jamaica is under a 27 month Stand By Agreement (SBA) with the IMF following the impact of the global financial crisis. Over this period it will receive US$1.27 billion, or SDR 820.5 million. The SBA was signed in February 2010. One of the platform of the SBA was the successful implementation of the Jamaica Debt Exchange (JDX). The impact of this was to reduce the debt burden of the Government which was constricting growth and development. The JDX was successfully launched with a 99.5% participation rate. The International Monetary Fund (IMF) last Friday completed the third review of Jamaica's economic performance under the standby arrangement (SBA) and approved the immediate disbursement of US$49.3 million.

As at the end of 2010, prudential indicators point to continued resilience of the financial system. Financial-sector reforms aimed at strengthening prudential requirements and the overall supervisory framework are moving ahead broadly on schedule. Inflationary pressures remain subdued, allowing an accommodative monetary policy. The FSSF was meant to be a US$950-million rescue fund for investment houses, and under certain circumstances, banks, that the authorities feared might have been weakened by the reduced returns on domestic securities on their portfolio, as well as pending financial reforms. Those fears have now eased and the IMF and GOJ plan to wind down the Financial System Support Fund (FSSF) over the course of 2011.
Although FSSF remains untouched, several challenges remain for the financial sector. First, the business model of the securities dealers, a major player in the financial sector, needs to accommodate to less lucrative returns with risks of outflows of deposits. Second, the exposure of the financial system to the GOJ securities remains high. Third, the non-performing loans, even though they are low, have been increasing since the beginning of the economic crisis. The average share of non-performing loans increased systematically since June 2007 reaching 5.9 percent of the total stock of loans in June 2010, more than double the figure observed in March 2008 (2.01 percent of total stock). However, provisioning remains relatively high at 70 percent.

ANNEX I

Comments on

Evaluability Notes
Projects: Liquidity Program for Growth Sustainability in Panama (PN-L1048), Dominican Republic (DR-L1040) and Jamaica (JA-L1023)

OVE observations on all three Liquidity Programs for Growth Sustainability (LPGS) along the four main evaluability dimensions can be summarized as follows:

1. Diagnosis: Lack of quantification of the unmet demand for credit to be filled through the Program.

2. Objectives: Unclear determination of Bank's additionality, output (access to credit) and especially outcomes (such as firm employment and productivity), all of which translated in poor definition of evaluation indicators.

3. Project Logic: No technical justification for country loan cap chosen, incomplete reference to final borrowers targeted by the program and no consideration of pros and cons of interventions other than LPGS.

4. Assumptions and Risks: Unsatisfactory discussion of some of the risks involved and absence of risk mitigation actions to contain moral hazard.

The present document replies by: (a) supporting the position that OVE evaluability rules are not fully suitable to judge an exceptional, emergency program like LPGS, and (b) presenting strong arguments on the correct diagnosis, project logic and objectives, risk mitigation and impact evaluation embedded in LPGS design and implementation. For the sake of clarity, the limited comparability of LPGS vis-à-vis other IDB programs is treated in Section A, while some specifics about LPGS diagnosis, goals, risk containment and evaluation measurement are presented in Section B.

A. Rationale and Exceptional Features of LPGS

Although we agree, overall, with OVE evaluability approach, we believe that there seems to be a misunderstanding on the part of OVE about the nature of this particular Bank operation. Standard IDB financial assistance initiatives are designed to overcome, over a medium- to long-term horizon, structural problems hampering economic, social and financial development in LAC countries. In light of these features, especially the relatively lax timeline and the ability to foresee the evolution of the main conditioning variables, such programs leave ample room for a thorough diagnosis and a clearly quantifiable impact evaluation framework.

In sheer contrast, LPGS was an emergency line aimed to keep an adequate flow of working capital and trade financing for small and medium enterprises in the smaller LAC countries in the midst of the subprime crisis. As a parallel and equally important objective, LPGS was thought to help put under control the widespread risk perception among economic agents across LAC.[4] LPGS was outlined and implemented over the course of a few weeks in the fourth quarter of 2008, not out of improvisation but as a rapid and necessary response to an unanticipated large shock hitting the region that called for immediate IDB intervention. Recalling that the subprime crisis stands as the deepest worldwide economic slump since the 1930s, and thus the hardest external shock on LAC economies in decades, LPGS represented a timely and well-conceived measure to cushion the productive contraction that interrupted the prior five-year bonanza. On theoretical grounds, multilaterals are well-equipped to intervene during crisis times in countries facing constraints in the implementation of countercyclical (fiscal and monetary) policies and lacking sufficient credit access from international creditors. Given the global nature and spillovers of the crisis, the exacerbated systemic risk at the national level and the difficulties to assess country's fundamentals, there appears to be a role for the IDB and other multilateral institutions as providers of backstop liquidity or lenders of last resort. Hence, by stepping up at a time that other usual sources of financing were limited, the IDB acted as a badly needed countercyclical stabilizer.

Bearing this in mind, it is easier to rationalize the ICM-CMF approach regarding the Program and defuse the core OVE observations. Specifically,

- OVE's definition of *evaluability* is *the ability of an intervention to demonstrate in measurable terms the results it intends to deliver*. This seems a proper definition when it comes to most IDB projects, where there exists a predictable linear relationship between inputs and outcomes. But emergency financial assistance programs such as LPGS, as well as any other financial crisis management package, must be judged against a different metric.
- Three key distinctive factors that separate LPGS from other IDB programs are (i) the confidence effect linked to emergency loans, (ii) the lack of an objectively quantifiable counterfactual, and (iii) the control over major risk factors.
- A small emergency loan can be quite effective if it helps restore public confidence. At the extreme, the mere announcement of the facility, without any disbursement, can bring on the expected stabilization effect. On the other hand, a large loan might be unable to overturn a highly uncertain global and local context. On the contrary, in a typical IDB program, it should be expected a direct link between loan size and outcome size.
- For a normal intervention, a correct impact evaluation hinges on identifying what the outcome would have been in the absence of the intervention. Although coming up with a proper counterfactual is always challenging, it is much more so during a crisis. For example, it is possible that the number of loans, or firm employment and sales, go down after the intervention, but without it such outputs and outcomes might have drastically shrunk. Consequently, the

[4] It is well-known that, by hampering consumption and investment, undermined confidence is a major driver of economic contractions in the course of financial crises. The proactive presence of the IDB, supplying fresh money when other sources were neglecting it, was intended to play a positive signaling role about country fundamentals, as was later empirically confirmed by a careful external impact evaluation –see Section B.

intervention should be deemed successful. However, intervention-free crisis scenarios are highly unpredictable (or, otherwise, predictable within too wide confidence intervals), which blurs the reliability of the evaluation. This incidentally explains why, in spite of the occurrence of more than 200 financial crises across the globe over the last three decades, there is no single technical impact evaluation on the effect of official bailout packages.

- Finally, in typical IDB programs, the analyst should be able to pinpoint all the risks facing the project and come up with mitigating strategies for most of them. Conversely, in emergency loans such as LPGS, program success is conditioned by many factors that are largely outside the control of the Bank and even the borrowing country. For example, the LPGS ex post evaluation carried out by ICF-CFM showed, on the basis of an econometric estimation, that local financial variables (such as interest rates and international reserves) were strongly influenced by changes in the US Dow Jones stock index. This case illustrates the fact that spelling out the risks, assumptions and mitigating actions may turn out to be fruitless, as many overarching factors are exogenous, unpredictable and unable to be undone by small interventions.

- The pressing need for a prompt intervention and an expedited execution of the program runs counter a protracted discussion in the Loan Document (LD) about competing approaches, a more precise estimation of potential demand for funds under different loan conditions, expected effectiveness under various macroeconomic scenarios, and so on. There was a patent trade-off between an urgent and hopefully successful intervention and a slower but tardy action. The former choice might involve some weaknesses from the OVE standpoint, but the expected social payoff of a timely intervention was sensibly thought to be much higher.

- Other multilateral organizations that set in motion their own assistance packages were forced to act under the same principle (during a crisis, the only valuable intervention is the early one). Hence, the criticisms voiced by OVE can easily apply, even more strongly, to emergency credit lines extended by the World Bank, the IMF and, at the national level, by the U.S. and several European countries. By the way, the fact that most of these peer organizations put in motion similar programs in LAC countries reinforces the conviction that there was an actual and urgent problem to address.

- Financial crises are dynamic events, whose evolution is hard to foresee in real time. This forces participants, including multilaterals such as the IDB, to continually adapt to the observed conditions in order to maximize the shock-absorbing role of assistance packages. In fact, most anti-crisis interventions around the world since 2008 have as a common thread an important degree of pragmatism and flexibility. Governments and multilaterals, faced with an unexpected crisis of catastrophic proportions, went through a learning-by-doing process, whereby the magnitude of the intervention and the instruments applied were periodically revised, on a day-by-day basis, to better respond to the prevailing financial environment. While on the surface this might be interpreted as a loose and unplanned resolution approach, it is actually the only viable strategy to successfully confront the crisis. The economic soft landing in the industrialized world after the massive bailouts of 2008-2009 gives some credit to this view. However, it is evident that none of these resolution processes would have passed the evaluability tests administered by OVE.

- This very lack of predictability at the peak of the crisis renders some of the preparatory work sterile. For instance, one may want to make a precise calculation of the required funding. However, the estimated demand for funds could be extremely high or low depending on the erratic evolution of international conditions and local confidence. No statistical model would have been likely to deliver a dependable estimation of the unmet loan demand. Again, the frequent adjustments in the size and applications of the bailout package in the US and other countries as the crisis unraveled reveal the difficulties involved in any crisis resolution process.

- By the same token, the OVE evaluation framework may be misleading and excessively harsh when applied to LPGS with the benefit of hindsight, as it downplays the conditions of extreme uncertainty reigning at the peak of the crisis and the larger risks of postponing its execution. LPGS was an exceptional and non-recurrent Program put in effect to cope with an equally unique event and, as such, ordinary evaluation benchmarks should not be applied to it.

B. LPGS and Evaluability Dimensions: Specific Comments

This section seeks to demonstrate that, over and beyond its peculiar context, LPGS design and implementation was grounded on sound arguments and actions regarding its diagnosis, goals, risk mitigation strategy and evaluation assessment. This view is supported by the following facts:

- In a nutshell, the Program sought to fill the gap between the supply and the demand for loans on the part of SMEs in the midst of the subprime crisis, when other funding sources were closed. The basic challenge in preparing the LD was the acute lack of information to measure such presumed excess demand. Credit supply and demand were shifting continually under the bombardment of positive and negative news, and as a result no rigorous statistical model could quantify them satisfactorily. Being fully aware of this, ICF-CMF structured LPGS as a contingent facility under soft eligibility rules and a fast track disbursement. Contingency was accompanied by a steep interest rate (including fees) compared to other IDB lines. These clauses were a clever way of liberating the IDB from the need to calculate the elusive concept of excess loan demand –the high cost, in turn, helped making sure that fund requests were made out of an emergency need and not for speculative or precautionary motives.

- LDs provided information on how the Program articulated with some government and multilateral initiatives that were in progress at the time. Nevertheless, it is well known that no country had a pre-established anti-crisis policy agenda, as the event was barely anticipated. The same problem precluded a better coordination between multilateral organizations and between the latter and domestic policy makers.

- Internal technical discussions were maintained before LPGS was launched, and pros and cons of alternative mechanisms were weighed and partially reflected in the Document. However, the need for expedited execution precluded ICF-CMF from a more prolonged debate. Likewise, loan caps were decided targeting the smaller LAC economies and after a preliminary agreement with country's authorities and the own ICF-CMF technical assessment of expected funding requirements.

- In terms of risk factors and the setting of evaluation indicators, it must be borne in mind that the Bank was not the direct creditor of the final borrowers targeted by the Program. In actuality, the

Bank has limited leverage over the multiple actors participating in the loan process, and thus its ability to set measurable outcomes is seriously undermined. As clear from the LD, the Bank engaged in a contract with the national government by which resources were to be transferred to a second-tier financial institution, which in turn would channel the funds to commercial banks in charge of selecting the final borrowers. In light of this somewhat cumbersome yet inescapable procedure, the Bank enjoys only partial control over the speed and efficiency in the allocation of funds, which also explains why strict outcome indicators could not be set.

- The advent of borrower moral hazard in the face of easy financing -after voluntary markets had temporarily dried up- is no doubt the most pervasive risk from the Bank perspective. These perverse incentives were adequately controlled by the rules set in the LD and the post-disbursement monitoring in the case of Jamaica and El Salvador. On the last issue, ICF-CMF teams successfully took every step to document the allocation of LPGS funds, at the level of each individual loan provided by the first-tier banks. Furthermore, the Program design eliminated limited liability, the main source of moral hazard in any debt contract, by requiring full government guarantees.
- Since the Bank was not the direct SME creditor and there was an understanding that commercial banks are best equipped to select new borrowers, adapt to their clients' needs, and determine the loan conditions (interest rate, term, collateral, etc.), LDs abstained from including rigid provisions regarding final loan characteristics and outcome indicators to monitor.
- Lax determination of the Program time frame (despite a maximum 5-year maturity, 3-year grace period was contractually determined from the outset) resulted from the inability of all interested stakeholders to foresee the length of the crisis. While sticking to the original plan of making LPGS a short-term scheme, ICF-CMF aimed to matching the Program timeline with that of the crisis peak, at least for as long countries were unable to resume their access to voluntary credit. Calling on LPGS loans in the midst of the crisis would have been a major setback for the sought stabilizing role of the Program. As any good crisis management guidelines would teach, if errors are to be made, it is preferable to be, from an ex post standpoint, exceedingly generous in setting maximum loan availability and maturity.
- The ultimate outcome evaluation would have required detailed access to microdata from the final borrowers, that is, SMEs that were granted LPGS-financed loans. After ensuring that such operations did not crowd out other clients from the bank loan portfolios, an impact evaluation should have been carried out (based on experimental or non-experimental methods) to know whether employment, sales and related indicators were affected by the intervention. Two reasons are behind the impossibility to run such evaluation: one, the necessary SME microdata are not available (mainly because SME financial records are highly unreliable, and first-tier banks had no obligation to disclose them to the Bank); and second, the turbulent changes around a crisis make it hard to disentangle intervention-specific effects from other contemporaneous shocks. Once again, these data constraints are behind the complete absence of impact evaluation studies concerning the effects of crisis management policies on business health (not only on SMEs but on firms at large).

- Regardless of the shortcomings to establish clear evaluation benchmarks, ICF-CMF has shown a healthy concern for the hard ex post evaluation of the line. To this end, an external consultant was hired to produce an evaluation paper. The empirical strategy revolved around GARCH models to test whether the public announcement of negotiations and of loan approval have had any impact on high frequency macroeconomic data, such as the country risk premium and the interbank interest rate. The evidence revealed a positive and significant effect on financial stability attributable to LPGS in Jamaica, El Salvador, Costa Rica, Dominican Republic and Panama. Remarkably, such positive effect on the mean and the variance of these macroeconomic series took place independently of the actual disbursement of this contingent line –actual, and partial, disbursements only took place in the cases of Jamaica and El Salvador.
- More specifically, it was found that, after controlling for autocorrelation and international market developments (proxied by the daily return on the Dow Jones), (i) the negotiation and approval dummies delivered a significant estimate with the expected sign for the mean equation in 10 out of the 12 cases (consisting of the five above countries plus Uruguay, and two binary variables of interest: Negotiation Start and Loan Signature); (ii) These variables have a significant impact on the variance equation in 6 out of 12 cases; and (iii) Regarding economic significance, coefficients vary across cases, but the average effect is a reasonable improvement of 11.2% in the mean value and of 9.8% in variance.

ANNEX II

LPGS - LO - 2116-OC

ANALYSIS OF WORKING CAPITAL AND TRADE FINANCE LOANS BY BANKS AND BY SECTOR

(Figures in US Dollars, number of Credits and percentages)
19-Jan-2010

Institution	Number of Borrowers	Amount	% Borrowers	% Amount	Minimum	Maximum
Bank A	44	23,000,000	57.1%	24.2%	4,810	5,805,153
	11	23,083,937	14.3%	24.3%	51,478	10,009,977
	16	45,816,439	20.8%	48.2%	300,000	13,000,000
Bank B	6	3,251,802	7.8%	3.4%	41,118	1,000,000
TOTAL	**77**	**95,152,178**	**100.0%**	**100.0%**		

Description of Activity (Sector)	Number of Borrowers	Amount	% Borrowers	% Amount	Minimum	Maximum
MANUFACTURING	24	16,353,256	31.2%	17.2%	18,803	5,805,153
TOURISM	11	42,030,936	14.3%	44.2%	31,575	13,000,000
SERVICE	11	13,681,803	14.3%	14.4%	7,970	10,000,000
MINING	1	4,810	1.3%	0.0%	4,810	4,810
AGRO-PROCESSING	15	10,658,564	19.5%	11.2%	7,536	3,759,998
DISTRIBUTION	7	1,202,340	9.1%	1.3%	8,343	500,000
CONSTRUCTION	4	2,207,323	5.2%	2.3%	150,000	1,339,696
OTHER	2	13,146	2.6%	0.0%	2,842	10,304
TOTAL	**77**	**95,152,178**	**100.0%**	**100.0%**		

Purpose of Loan	Number of Borrowers	Amount	% Borrowers	% Amount	Minimum	Maximum
WORKING CAPITAL	66	89,394,464	85.7%	93.9%	4,810	13,000,000
TRADE FINANCING	11	5,757,714	14.3%	6.1%	8,343	2,003,511
TOTAL	**77**	**95,152,178**	**100.0%**	**100.0%**		

Range of Amounts Contracted	Number of Borrowers	Amount	% Borrowers	% Amount
> $1,000,000.00	23	81,511,968	29.9%	85.7%
>$500,000 **<=**$1,000,000	9	6,939,067	11.7%	22.3%
>$100,000 **<=**$500,000	23	5,922,888	29.9%	22.5%
>$50,000 **<=**$100,000	7	388,579	9.1%	5.4%
>$10,000 **<=**$50,000	11	361,018	14.3%	5.4%
Less than $10,000	4	28,658	5.2%	0.6%
TOTAL	**77**	**95,152,178**	**100.0%**	**100.0%**

	VALUE OF SECURITIES PLEDGED BY AFIs AS AT JANUARY 13, 2010						
Securities Held	Face Value US$	Bid Price	Market Value - US	Offer Level	Offer Yield	oan Amount US	Amount To Be Held - 110%
GOJ Global Bond 2011 - 11.75%	2,000,000.00	100.000	200000000.000	102.000	10.07%	23,083,937.00	
GOJ Global Bond 2022- 11.625%	4,148,000.00	102.125	423614500.000	106.125	10.71%		
GOJ Global Bond 2025- 9.25%	5,300,000.00	83.000	439900000.000	86.000	11.15%		
GOJ Global Bond 2039 - 8%	8,000,000.00	72.500	580000000.000	75.500	10.77%		
GOJ Global Bonds 2036- 8.5%	5,090,000.00	73.000	371570000.000	77.000	11.24%		
GOJ Global Bonds 2017-10.625%	1,017,000.00	94.000	95598000.000	96.000	11.44%		
TOTAL	25,555,000.00		2110682500.000			23,083,937.00	25,392,330.70
							Additional Security Reqd.$
							-2,085,290,169.300
CAP 2021 - 8.5%	31,930,000.00	72.000	2298960000.000	78.000	12.03%	45,083,101.00	
Air Jamaica - 2027 - 8.125%	17,847,000.00	66.000	1177902000.000	70.750	12.22%	733,338.00	
GOJ Global Bonds 2017 - 10.625%	18,000,000.00	94.000	1692000000.000	96.000	11.44%		
TOTAL	67,777,000.00		5168862000.000			45,816,439.00	50,398,082.90
							Security Adequate
GOJ Global Bonds - 2019- 8%	3,580,000.00	80.000	286400000.000	84.000	10.74%	3,251,802.00	3,576,982.20
TOTAL	3,580,000.00		286400000.000			3,251,802.00	Additional Security Reqd.
							-282,823,017.8
GOJ Guarantee - (Unlimited)						18,000,000.00	
						5,000,000.00	
TOTAL						23,000,000.00	

	VALUE OF SECURITIES PLEDGED BY AFIs AS AT JANUARY 19, 2010						
Securities Held	Face Value US$	Bid Price	Market Value - US	Offer Level	Offer Yield	oan Amount US	Amount To Be Held - 110%
GOJ Global Bond 2011 - 11.75%	2,000,000.00	100.000	200000000	102.000	10.06%		
GOJ Global Bond 2022- 11.625%	4,148,000.00	102.125	423614500	106.125	10.70%		
GOJ Global Bond 2025- 9.25%	5,300,000.00	83.000	439900000	86.000	11.15%		
GOJ Global Bond 2039 - 8%	8,000,000.00	72.750	582000000	75.750	10.73%		
GOJ Global Bonds 2036- 8.5%	5,090,000.00	75.000	381750000	79.000	10.95%		
GOJ Global Bonds 2017-10.625%	1,017,000.00	94.000	95598000	97.000	11.23%		
TOTAL	25,555,000.00		2122862500			23,083,937.00	25,392,330.70
							Additional Security Reqd:
							-2,097,470,169.30
CAP 2021 - 8.5%	31,930,000.00	73.000	2330890000	77.500	14.04%		
Air Jamaica - 2027 - 8.125%	17,847,000.00	68.000	1213596000	72.000	12.77%		
GOJ Global Bonds 2017 - 10.625%	18,000,000.00	94.000	1692000000	97.000	11.23%		
TOTAL	67,777,000.00		5236486000			45,816,439.00	50,398,082.90
							Security Adequate By:
							5,186,087,917.10
GOJ Global Bonds - 2019- 8%	3,580,000.00	82.000	293560000	86.000	10.36%	3,251,802.00	
TOTAL	3,580,000.00		293560000			3,251,802.00	3,576,982.20
							Additional Security Reqd. By:
							(289,983,017.80)
GOJ Guarantee - (Unlimited)						18,000,000.00	
						5,000,000.00	
TOTAL						23,000,000.00	