INTER-AMERICAN DEVELOPMENT BANK INTER-AMERICAN INVESTMENT CORPORATION

ANNUAL MEETING OF THE BOARDS OF GOVERNORS

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ADDRESS BY THE ALTERNATE GOVERNOR FOR BELGIUM AT THE SECOND PLENARY SESSION

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1. In the name of the Governor for Belgium, Mr. Didier Reynders, and on my own behalf, I would like to thank our host country, its people, and the city of Fortaleza for their organization of this meeting. Although this is the fifteenth annual meeting I have attended, the experience is always very helpful in terms of staying in touch with the region and the Bank. I am pleased that our meeting is being held in this region which reflects the challenges facing the continent and our institution.

2. At the conclusion of the work performed under the auspices of the Committee of the Board of Governors, the Bank now has new directives regarding commitments.

3. At the same time, the External Advisory Group has submitted its conclusions and recommendations that aim to allow the Bank to pursue its modernization and to serve its member countries more effectively. We will follow the discussions of this issue within the Board of Executive Directors with great interest, but it seems appropriate to offer a few comments on this matter, which I shall do later in this address.

4. The Bank is engaged in an intensive effort to improve various aspects of its operations, and Belgium welcomes these endeavors. The effort must continue: the relevance of our interventions requires periodic reappraisal in light of lessons learned from the evaluation of operations and the assessment of their impact. In light of what we have learned from analyses of development effectiveness and quality, the various areas of activity in which the Bank is authorized to engage should be prioritized based on their contribution to the progress of borrowing countries, to better discern the causal connections between the various problems that arise so as to concentrate our efforts on the underlying problems rather than on their symptoms or consequences.

5. I would like to address certain aspects of the working group's conclusions that have rekindled discussion of the respective merits of policy-based lending and investment lending.

6. Our approach to policy-based lending is prudent, and this prudence does not derive from skepticism about the reforms themselves. Inappropriate policies, of course, have put

growth at risk. Implementation of the Consensus of Washington recommendations has remedied the situation to some extent, but the adoption of good policies does not bring about growth and reduce poverty automatically. Thus despite clear improvements in economic policies, the region initially experienced a lower growth rate than Asia –even though many institutions and policies there were not and are not in compliance with official requirements– and was then affected by the international economic slowdown that began a few months ago. Consequently, we would like to see borrowers conduct certain reforms on their own, and to see the Bank display prudence and selectivity in choosing the reforms that it is called upon to finance. This should reduce the risk of being drawn into a vicious circle of financing deficits. Although these reforms are not the most adequate answer to the problems encountered, in most cases they will translate into new spending cuts in exchange for long-term financing, the future burdens of which will absorb an increasing share of revenues to the detriment of missions that the State is already finding difficult to carry out.

7. To avoid a situation in which borrowing repeatedly replaces the mobilization of local resources, with all the dangers that this entails, increasing government revenues is another avenue to be explored more vigorously. Owing to problems with the application of existing tax laws, in some instances revenues are only a third of what they should be. One of the main reasons for the better performance of industrialized countries is that nearly all tax revenues are collected, enabling institutions to carry out their work. Consequently Belgium appreciates the Bank’s recent efforts in the key area of modernization of the State, and welcomes the steps that some governments have taken in this direction. However, the Bank and the governments of borrowing member countries must take more resolute action, given the relatively modest cost of such operations in comparison with their potential high rate of return, particularly in consideration of the flexibility that governments will gain in various areas of economic activity.

8. Additionally, we must take care not to overestimate the impact of direct foreign investment or to believe that foreign investors will pour in automatically thanks to improvements in the business environment. It seems more prudent for most borrowing countries to rely on their own strengths by supporting their own investors. Accordingly, Belgium welcomes the Bank’s renewed interest in small and medium-sized enterprises. In our view, this essential action should focus on three areas in which the Bank has experience and a comparative advantage: reducing red tape through programs promoting modernization of the State and good governance; access to credit, particularly during difficult periods; and manpower training. These are also essential ingredients for attracting direct foreign investment, which seeks dynamic local subcontractors and skilled labor, among other things.

9. Various consumer and business confidence indexes in industrialized countries show that hope is a key ingredient for investment. To generate growth, investment must be a collective effort, in the sense that although an individual may be willing to invest, he will refrain from doing so if most others are hesitant to commit. Therefore, it is extremely important to restore a climate of confidence among local economic agents, which has been undermined by a period of extreme turbulence characterized by the contagion of 1998, the crisis in Argentina, and the international economic slowdown. In this respect, it is essential for government authorities to hold the course of recent years in terms of sound macroeconomic management even when results are slow to appear, as is now the case.

10. Finally, the new lending instruments have not yet been the subject of detailed discussions. The information available about most of these instruments is promising. However, some of them relate more to finance than to development and, in the absence of evidence to the contrary, are fairly incompatible with our present mandate. One instrument that is worthy of our interest is lending to subnational entities. There is consensus regarding the important role of these levels of government for development, but a majority expresses clear reservations about such financing without a central-government guarantee. It seems fitting to reconcile these points of view. I imagine that the proposal's initiators are demonstrating confidence in their subnational entities, and therefore that it is for reasons other than the possible execution of these guarantees that they wish to do without them. These reasons may include an increase in their own indebtedness, for example, which would risk raising their borrowing costs. One option worth exploring would be to obtain prior agreement from beneficiaries of loans without guarantees that repayments to the Bank will be deducted at the source from resources transferred to it by the supervisory authority, so as to guarantee loan repayment in another form. However, borrowing in foreign exchange by entities whose revenues are in local currency entails risk, as recent crises have reminded us.

11. I will conclude with a few comments on the report of the External Advisory Group. The main issue for nonborrowing shareholders seems to be a future IDB-9, despite the agreement at the time of IDB-8 that it would be the last replenishment. Of course, the issue of relevance also arises in quantitative terms when we consider the scope of capital flows and the size of the region's economy. On an annual basis, the Bank's commitments amount to only .15 to .2 percent of regional GDP. Whether we like it or not, these facts are significant when it comes to getting a message across and establishing adequate incentives to obtain the desired response. In addition, owing to the use of Fund for Special Operations resources for debt relief under the HIPC Initiative, we have already agreed to review the Bank's concessional resource requirements in a few years. Accordingly, it may be appropriate to link the review of concessional resource requirements to the broader issue of the level of resources that it would be desirable for the Bank to have in order to carry out its mission.

12. The second issue to be discussed is the suitability of transforming the Private Sector Department into an affiliate in its own right. On its face, this initiative would seem not to have an impact on the resources and missions of the Bank, since it involves their transfer to an autonomous entity with different missions and risk profiles. An analysis of the risks and benefits of the formula deserves a more in-depth examination, and the decision on this issue should be taken at the level of the Governors.

13. The third major issue is assessing the value of the capital subscribed by the borrowing countries. The World Bank is asking itself the same question. This issue is of even greater relevance as the region has just emerged from a difficult period characterized by repeated financial crises, and will soon face another challenging period if economic recovery is slow to take shape at the international level. It will be equally important to determine what this capital will be used for, and whether it is desirable to allocate it to an increase in commitments. A detailed analysis should be undertaken in this area as well.

14. Finally, I would like to take this opportunity to note once again that Belgium remains interested in hosting a future annual meeting of the Bank.