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**ADDRESS BY THE TEMPORARY ALTERNATE GOVERNOR FOR
THE UNITED STATES OF AMERICA
AT THE SECOND PLENARY SESSION**

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1. This is my first Board of Governors meeting. At the time of last year's meeting I was still awaiting confirmation of my appointment by the United States Senate. I was very disappointed that I could not attend last year. But I have been looking forward to attending this year's meeting and I am happy to be here today.
2. This past year has been a challenging one for all of us. Our attention has been drawn to important new tasks, such as combating the financing of terrorism and restoring economic growth after last September's terrorist attacks. At the same time we continued to deal with the difficult problems of economic instability, slow growth, and reduced capital flows in the region.
3. Some say that the problems of this past year have diverted attention from the region and have eroded the commitment of the United States to increased trade, free-markets, and democracy in the hemisphere. Nothing could be further from the truth. We are neighbors and friends. Geography, culture, history, and the strong bonds of mutual economic and security interests tie the Americas together. The United States remains committed to this friendship.
4. The Inter-American Development Bank (IDB) is an essential part of this friendship—playing a role in economic development in the region. Today I would like to discuss how we should build on the successes of the IDB to make the hemisphere a better neighborhood—one characterized by more economic growth and less poverty.

Productivity Growth in the Hemisphere

5. The place to begin talking about economic development is with productivity growth. Poverty reduction and higher standards of living cannot occur without productivity growth. Productivity is simply the amount of goods and services a worker can produce in a particular period of time. The higher productivity is in a country or a region, the higher income per capita is in that country or region. You can see that by comparing the richer and the poorer countries in our region.
6. For the countries of Latin America as a whole the 1990s were better than the 1980s in terms of productivity growth, reflecting many economic reforms, especially in the macroeconomic areas. Productivity growth was 0.7 percent per year in the region as a whole in the 1990s after averaging below zero in the 1980s. That is an improvement, of course, but I believe there is room for much more improvement.
7. During the period that productivity growth was 0.7 percent in Latin America, it was 1.7 percent in the developed countries, and 2.7 percent in the East Asian countries. That 1 percent or 2 percent productivity difference could have made a huge difference in living standards in the region. Productivity growth in the United States is projected to be at least 2 percent in the next few years. Productivity growth in Latin America should be higher than 2 percent—or more than triple what it was in the 1990s.
8. While productivity is not a new thing, experience and research during the recent years have taught us many new things about productivity. As a matter of accounting, productivity will grow if capital—including human capital—per worker grows or if technology improves. The reason why I think that the productivity potential is so much higher in the region is that there is so much room to increase capital—including human capital—and to adopt cutting edge technology in use around the world today.
9. So, when evaluating a loan or a grant the IDB should look at its effect on productivity. That will lead to activities that will raise living standards and reduce poverty. I was very glad to see the emphasis placed on productivity growth in the recent report of the IDB, *The Business of Growth*. Secretary Paul O'Neill gave his strong endorsement of that report when he spoke at the IDB last fall. Using the latest research and data, the report demonstrates that more investment and more education in the region will increase productivity.
10. The report also shows that an improved business climate—a more consistent rule of law, better control of corruption, fewer obstacles to starting a business—will raise productivity. And the report shows that there is room for improvement. For example, in Canada it takes 2 “procedures” to start up a business; in the United States it takes 4 and in Latin America it takes 12. And the report points out important success stories such as the Oportunidades, formerly known as Progresa, program in Mexico and the Bolsa Escola program here in Brazil which provide funds to families with low incomes whose children

attend school. I am pleased that the IDB is using this model to develop educational programs in other countries.

Measurable Results

11. To achieve success in any endeavor it is necessary to have measurable results. That certainly holds true in our endeavor to raise productivity growth. We must be sure that the activities of the IDB actually do the things they are supposed to do. While nearly everyone welcomes the recent increases in funding for education by the IDB, we should not be satisfied with the funding alone. We must look at the outputs. Is enrollment increasing? Are more children graduating? Are literacy rates rising? Close monitoring is needed to assure that tangible, measurable results are being obtained. It is not enough to look at input. It is output that counts.

12. It is good that the IDB has already started strengthening the independent evaluation office a process that has prompted candid debates about results. But it is not enough to have a separate and independent evaluation unit. Quality has to be built into every project at the early design stage, before it is presented to the Board of Directors, with clearly stated output-based objectives. I understand that during this past year, the independent evaluation office reviewed every loan proposal to see if it contained adequate indicators to measure results. I also understand that the review shows a broad need for improvement. This is a special challenge for the line managers in their day-to-day operations.

13. Some of you may know that the United States has proposed a large 18 percent increase in funding for the World Bank's International Development Association (IDA) in the current replenishment. We have also proposed that the year-to-year increments in this replenishment be tied to measurable results. Although an FSO replenishment is not immediate, the approach we are now proposing for IDA should eventually apply to FSO. If resources can be shown to be delivering effective economic development, the United States will be ready to make meaningful financial commitments.

Strengthening the Private Sector

14. Economic development will falter and fail without a strong private sector. Without a transparent economic environment based on the rule of law, private investment simply will not happen. This is especially important for small and medium sized enterprises, since opaque regulatory and legal environments create insurmountable barriers to entry. These barriers must be removed if the region is to grow rapidly.

15. The IDB and the other development banks can do more to promote private sector development. This will include giving practical investment climate assessments and providing more loans to small businesses. Work on improving transparency and governance in each country remains the biggest challenge.

16. We further need to remove the continuing obstacles to hemispheric integration. The United States is committed to the Free Trade Area of the Americas so that all the countries of the region can benefit from the free flow of goods and services. We know that this process will not be easy. The IDB is doing important work on trade capacity building.

17. The recent report by the IDB External Advisory Group gave particular attention to the private sector operations. I share the view expressed in that report that the IDB needs to strengthen risk management and evaluation functions for its private sector operations and for the IDB as a whole.

18. I would also like to comment on the work of the Multilateral Investment Fund in strengthening the environment for the private sector in Latin America. Its investment and technical assistance for Caja Los Andes in Bolivia, for example, enabled that institution to increase its portfolio seven fold, improve the efficiency of credit officers, and transform itself from an NGO to a full fledged formal financial institution. The MIF realized an internal rate of return of 17.9 percent when it exited Caja Los Andes in 2001, demonstrating that small business finance can be profitable.

19. We were pleased to support the extension of the MIF for 5 years so it can fully utilize its existing resources. The MIF and the IDB are focusing on reducing the transaction costs of remittances to Latin America and the Caribbean—a flow that is estimated to have grown to \$23 billion last year.

The Importance of Grants

20. The IDB needs to look at grants as an important development tool. President Bush proposed increasing the share of development bank support for poor countries that is in the form of performance-based grants. Grants are appropriate for projects that fail to generate the revenues needed to service loans. It does not make sense, for example, to finance disease interventions such as HIV/AIDS with loans. Education support can also be in the form of grants. There is already agreement that a larger share of support from IDA and from the African Development Fund should be in the form of grants, though there is debate about how large that share should be.

21. How does the IDB fit into President Bush's grants proposal? Again there is currently no FSO replenishment underway. However, the IDB could use a portion of resources resulting from emergency lending to provide grants. If grant programs can be funded from this source, it will also take some pressure off the FSO, leaving added resources for the very poorest countries.

Conclusion

22. I have noted a number of difficult obstacles to economic growth in the region today. I have also noted that it is possible to remove these obstacles and achieve the goal

of substantially higher economic growth. I am confident that the goal can be met successfully in the years ahead, and the IDB can play an important role in achieving this goal. Of course, we as shareholders must continue to ask the tough questions about productivity and measurable results. As President Iglesias has said, the goal of economic growth is the “business of the Inter-American Development Bank,” and we look forward to working with him on this goal in the future.