

**REMARKS BY MR. ENRIQUE V. IGLESIAS,
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TO THE EIGHTY-SECOND MEETING
OF THE COMMITTEE OF THE BOARD OF GOVERNORS**

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I. *Where we are coming from: the 1990s*

During the 1990s the Bank faced a series of new challenges that were associated mainly with overcoming the profound crisis that swept the region in the 1980s, the so-called “lost decade”. The region had not seen such a severe economic crisis since the Great Depression. Addressing it forced the countries of Latin America and the Caribbean to undergo a painful but unavoidable process of economic adjustment. The countries’ response capacity to this external shock was severely limited by structural weaknesses and rigidities in their economies, due in part to high external debt, huge fiscal deficits, a lack of strict monetary policies, and the loss of competitiveness on international markets.

A. *The Seventh Replenishment – 1989*

The Seventh Replenishment negotiations, which culminated in 1989, called on the Bank as a multilateral financial institution to help resolve the crisis and gave it clear mandates to guide its activities and instruments to carry them out. For the countries of Latin America and the Caribbean to achieve economic recovery, external financial resources were needed to finance imports of intermediate and capital goods and restore economic growth. The countries could certainly not expect growth to be based exclusively on restoration of domestic savings. Obtaining external resources was an essential condition—although not the

only condition—to help break the link between the limited supply of domestic savings and demand for investment. However, improvements were also needed in public policy as a whole. Accordingly, the Seventh Replenishment emphasized three areas in particular: (1) improving economic efficiency in all sectors of the economy, without any a priori restrictions, by providing governments that agreed to undertake a policy reform program with fast-disbursing resources and technical-cooperation funding where necessary to strengthen their technical capacity to manage the new public policy frameworks; (2) maintaining the target set during the Fifth and Sixth Replenishments to ensure that **50%** of the investment lending program would benefit low-income groups; and (3) protecting the natural resource base on which economic development depends by strengthening environmental management as a development objective and supporting relevant public policy.

The Governors also stressed the importance of creating opportunities for small enterprise owners and for women, recognizing the role of the informal sector in regional economies and of women as the architects of social change within families and through their entry into labor markets.

This approach was intended to reverse the serious economic deterioration, help pay off long-term debt, and prevent any further erosion in the social conditions of the masses. The depth of the crisis had forced practically all the countries in the region to take measures to address these external shocks. The reforms sought not only to restore macroeconomic stability but also to reestablish conditions conducive to investment, reducing the uncertainty associated with harmful macroeconomic imbalances.

During the eighties, the gradual resolution of the debt crisis kept the countries of Latin America and the Caribbean out of the international private capital market. Recovery was based to a great extent on the support provided by official bilateral and multilateral organizations. The Seventh Replenishment gave the Bank a specific new financing instrument, separate from its other available instruments, to help resolve the crisis—*sector loans*—which were designed as a flexible means of providing fast-disbursing funds. Sector loans were specifically conceived to support policy and/or institutional changes without any

a priori restrictions as to sector or subsector. They were intended to be disbursed in two tranches over a period not expected to exceed two years. Use of sector loans was to be decided during the programming exercises the Bank conducted with each country and candid policy dialogue between the Bank and its borrowers, based on a review of the policy measures necessary to improve sector performance.

The Bank had traditionally been associated with financing for physical infrastructure, both economic and social, and with support for productive sectors, such as agriculture and industry. It was now being called upon to help support the major reforms being launched in the eighties and early nineties, following general guidelines established by the Bretton Woods institutions and agreed upon with the respective governments. With a cap on sector lending set at 25% of the total lending program for the period from 1990 to 1993, the Bank joined the World Bank in proposing and formulating loans to support sector reforms, building on its considerable experience in and knowledge of Latin America and the Caribbean.

B. The Eighth Replenishment – 1994

The Bank took a big step forward when its Governors instructed Management to focus their attention on addressing the key issues emerging in the development process: worsening social problems, modernization of economic structures, integration, and deterioration of the environment. In the Seventh Replenishment, as we just saw, the Bank moved forward in its support for structural reforms, alongside the World Bank. By contrast, the Eighth Replenishment exercise undertook a comprehensive review of the Bank's action in a broad spectrum of objectives and instruments and represented a huge innovation in terms of both its scope and depth vis-à-vis the mandates of other multilateral development banks to date. The Eighth Replenishment thus became a veritable navigation chart to guide the course of Bank policies to support the countries in the region at a crucial turning point for reviewing and overhauling their economic and social policies.

As you may recall, the Eighth Replenishment identified three clear-cut areas for the Bank's action in the region, in addition, of course, to the areas identified in the Seventh

Replenishment: poverty reduction and enhanced social equity; modernization and integration; and the environment.

The *fight against poverty and inequality* was to be carried out through “a wide range of activities closely linked to social reform and poverty reduction.” The Bank was instructed to provide support for a broad range of initiatives, ranging from the needs of families, women, and young people, health and nutrition, and human capital formation to the program to improve the efficiency of social spending, emergency programs, and decentralization programs.

To focus the Bank’s activities on the social sectors, Management was asked to allocate a substantial proportion of the annual volume of lending to programs and projects that qualified as social, which were to account for no less than 40% of the total annual volume of Bank loans and 50% of the total number of operations approved.

The second major objective of the Eighth Replenishment was to *support economic and social modernization*. The Governors gave clear instructions in this connection to support competitiveness by concentrating on programs for domestic and foreign private investment in the productive sectors, strengthening for institutions for training and technology generation and dissemination, support for small and medium-sized enterprises (SMEs), reform and modernization of the financial sector, expansion of infrastructure, and so on.

Modernization of the public sector was to support reforms designed to improve governance, not only through macroeconomic stability, reform of social services, and maintenance of social security systems compatible with fiscal solvency, but also through broad-based reform of government institutions.

As part of these measures to achieve growth with competitiveness and openness, priority was assigned to *economic integration* in regional markets as “one way to achieve the ultimate objective of a multilateral opening up vis-à-vis the rest of the world, on a nondiscriminatory basis”. Ultimately, to support modernization and integration, economic

growth, which had been extremely depressed during the eighties, was to be substantially increased. However, it only recovered slightly in the nineties.

The *objective of protecting the environment* was assigned special priority by the Governors in response to the increased awareness that the growth resulting from the activities of the Bank and its member countries needed to be sustainable. Various aspects of this issue were to be covered, including strengthening the legal framework and institutions and energy conservation and efficiency for sustainable urban environment and natural resource management.

The Eighth Replenishment also gave the Bank *new instruments* and revamped old ones. The Governors stressed the importance of *country programming as an instrument for development and the need to adopt our own institutional strategy planning*. Strategy formulation in each country, based on an intense, ongoing dialogue with the country authorities and representatives to identify a mutually agreed work program for financing and technical cooperation, has been at the core of the Bank's relations with its borrowing member countries. This stems from the idea that, in order to maximize its development impact, the Bank's program as a whole needed to be consistent with the specific development needs of each country and therefore had to be specially tailored to each specific case.

Another instrument that was reviewed under the Eighth Replenishment was *policy-based lending*, which had been called sector lending under the Seventh Replenishment. Since the basic reforms such lending had targeted were considered to have been completed in the early nineties, at Management's suggestion, the cap on policy-based lending was now reduced from 25% to 15% of the program.

A third instrument introduced under the Eighth Replenishment was *direct lending and guarantees for the private sector without sovereign guarantees or counterguarantees*. Establishment of the private-sector window as a development tool represented a major *innovation* in Bank policies. Given the need to build experience and initially limit the risks entailed by such operations for the Bank, the Governors set caps on the Bank's share of such

funding to US\$75 million or 25% of the total cost of each individual project and 5% of annual authorized commitments. The individual and overall caps were reviewed and increased by the Governors in 1998, in order to promote financing for such projects in less developed countries. Bank financing for projects in Group C and D countries could reach 40% of the total cost of a project. For political risk guarantee operations, the cap was raised to 50% of the total cost or US\$150 million. The original overall cap was replaced with a new cap calculated at 5% of the outstanding balance of the Bank's loan portfolio, effectively increasing the private-sector window from US\$350 million to US\$550 million annually.

Lastly, the Governors underscored the essential role of technical cooperation in guaranteeing the success of the member countries' development efforts and of the Bank's loans. Technical assistance was needed for a vital and growing part of programs to support policy reforms, strengthen institutions, and build local capacity in basic sectors.

After a decade of changes and reforms, what has the region achieved?

I will not repeat what I have shared with the Governors on this topic on various occasions. But to summarize, without minimizing the differences among the countries and special situations, or the relativity of the averages, we have encountered the following major achievements and frustrations in the work we have done.

C. Achievements

One of the most significant achievements in Latin America and the Caribbean has been the *consolidation and deepening of democratic regimes*. Without such significant accomplishments in this area, it would not have been possible to move forward with the modernization of the economies and societies of Latin America. Active participation by all citizens in the modernization process should be promoted and enhanced by every available means. The countries in the region have found that respect for freedom and human rights constitutes a core value of the democratic system. With all the problems countries still face, they are working towards decisive, consistent practice of values and ethical principles without which democratic governance loses significance. Democracy must guarantee human

rights—understood to mean political, economic, social, educational, and cultural rights—since they are all intimately linked to the basic nature of mankind and human dignity.

In terms of *economic achievements*, *macroeconomic equilibrium* was restored. With it, inflationary expectations receded, the economies of the region opened up, with significant initiatives and programs for integration within the region and with other parts of the world, progress was made in reform of the State at various levels, and, in general, there was a noteworthy improvement in macroeconomic management and in government policies. To correct the huge budget deficits that had unleashed rampant inflation in the eighties, the massive economic resources managed by the State had to be pared back. In allocating resources, the private sector's comparative advantage in providing services and producing goods needed to be restored. International rescheduling of the external debt, in conjunction with vigorous exports and increased capital inflows, helped to improve economic performance in the region after several years of stagnation. The dramatic rise in capital inflows in the nineties exceeded all expectations, but also proved to be terribly erratic.

Policy reforms were primarily designed to restore the role of price signals in the allocation of resources by creating and sustaining a policy framework that would support economic recovery. Accordingly, reforms in foreign trade, the product and factor markets, and financial markets were undertaken to reestablish the relative price index system, which had become severely distorted through a complex tangle of regulations and interventions. In some countries, national currencies as a means of payment and unit of account had virtually disappeared because of hyperinflation.

To foster *international trade* and eliminate the distortions that made goods and services more costly, the countries in the region drastically reduced tariff barriers, dismantled import controls and restrictions, and phased out multiple exchange systems. Regional integration experienced renewed growth. Bilateral, subregional, and extraregional initiatives deepened the liberalization of trade and supplemented the overall process of opening up the economies and implementing structural reforms.

Financial reforms were launched with an eye to improving the allocation of resources from domestic and foreign savings and consolidating a creditworthy, revenue-generating financial intermediary structure. This effort stressed the need to maintain high capital adequacy requirements, establish a modern system of monitoring and safeguards, and allow foreign institutions to participate in the sector. However, the progress made has not been equally far-reaching in all the countries. In certain cases, there are still serious regulatory and supervisory deficiencies that stand as an obstacle to macroeconomic stability.

Tax reform has also been deepened, although less consistently among the countries. Its most common features have been neutrality, legal and administrative streamlining, and increased collections. However, enforcement of tax legislation remains weak in many countries in the region, and collection levels vary greatly.

Reform of *government enterprises* has been critical, both for the stabilization program and for structural reform aimed at reducing the fiscal deficit caused by autonomous agencies and increasing the coverage and efficiency of the public service infrastructure. At the same time, reforms have opened up new opportunities for private investment, both domestic and foreign, with a positive impact on productivity and efficiency. Although the scope and pace of privatization differed greatly from one country to the next, Latin America remained at the forefront of this process in the 1990s.

Another front on which the countries in Latin America worked was *pension system reform*. The pay-as-you-go systems, which constituted a fiscal time bomb, gradually gave way in eight countries in the region to new systems based in whole or in part on the principle of individual accounts that stimulate savings for a growing number of taxpayers of working age. However, the reforms also eliminated a traditional source of public-sector financing, making it more difficult to achieve fiscal equilibrium. The governments then had to resort to borrowing to finance the transition from the old system to the new one.

The region is better managed today, and international financial institutions clearly have contributed to this improvement. Structural reforms have helped to promote a positive image of the region in international markets, and account in part for the great inflow of

foreign investment attracted throughout the nineties at a sustained pace that has exceeded US\$50 billion annually over the past few years. They have also led to increased flows of short-term financing and general access on the part of the public and private sectors in a few countries to international financial markets.

The ability to formulate and manage public policy is a crucial issue for any modern State, and has two basic ramifications. First, accurate, comprehensive, timely information needs to be generated for the decision-making process; and second, citizen awareness of public policy and an understanding of its impact on the average citizen is crucial, and not only for better informed or organized groups. There is a vast distance still to be covered in terms of the effectiveness of the State apparatus to manage public policy, disseminate it, and correct it where necessary, with emphasis on the importance of average citizens understanding government decisions. The effectiveness of government institutions is particularly important considering its impact on the cost of doing business, especially for small and medium-sized enterprises.

D. The frustrations

It is also important to review the major *frustrations* experienced in most of our countries. They focus on three principal sources of vulnerability that characterize Latin America today: growth, the social sectors, and foreign economic relations.

Although *the economic growth rate* did recover during the nineties compared with the eighties, it was modest and also volatile. Not until 1997 did it rise above the rate posted in the early seventies. Discussions at seminars held in conjunction with this annual meeting have highlighted the strong impact of external factors on economic performance in Latin America and the Caribbean. The international environment is crucial in order for growth rates in the region to recover. It was clear from the discussions that although various countries differed as to how much external factors had affected them, economic fluctuations in the region follow a consistent pattern in all the countries, suggesting that there are common factors outside the region that are important for economic growth.

Researchers have found a clear link between growth and the magnitude of net capital inflows to the region. Volatile inflows are associated with high volatility in the growth rates posted in the region. Research has also shown that an increase in capital inflows equivalent to 1% of GDP typically increases investment by like proportions and increases growth by almost 0.4%. By contrast, during periods in which access to external financing tightens, growth slows, by close to 1% of GDP when external financing declines in like proportions.

External vulnerability continues to be a concern, as it was in earlier decades. Some 70% of our exports continue to be raw materials, which are highly vulnerable to price fluctuations. We also continue to be dependent on high inflows of foreign private investment and, in certain countries, on short-term financial flows that are just as volatile and subject to the phenomenon of international contagion, as occurred during the Asian and Russian crises. In addition to international contagion, we also suffered from regional contagion, when external factors or inadequate domestic policies allowed the economic crises in some countries to spread to neighboring countries.

Again, the availability of external financing also played a critical role in mitigating external shocks, preventing consumption and investment levels from deteriorating, for example, in the case of natural disasters, or helping to alleviate the impact of declining export prices for our commodities on investment and growth rates. The region's vulnerability to price shocks was amplified, as I mentioned earlier, by the lack of diversification in exports. This situation has the perverse effect of threatening the solvency of the country affected, which then prevents it from gaining access to financial markets in order to address external shocks. The lack of diversification of exports in the region has been extremely costly and highlights the vulnerability of Latin America and the Caribbean.

Social development has only been partially achieved, despite increases in social spending. Although poverty declined slightly in relative terms, it increased in absolute terms. In the developing world, Latin America has the highest level of inequality. Other pressing social problems are unemployment, exclusion of certain social groups, and new problems in contemporary society such as the breakdown of the family, violence, and organized crime.

External factors also help to explain part of the situation. When access to capital markets tightens, a dramatic collapse in economic activity often ensues. This collapse in the real economy, the so-called “slowdown,” unleashes a destructive process. Credit then disappears and production is strangled. The drastic slowdown in economic growth and recession that the drop in capital inflows causes, as occurred in 1982 and after 1998 (the Russian crisis), has been estimated to represent an average loss in growth equivalent to 2% of GDP between the years with and without access to the financial markets. This alone represents a dramatic change in opportunities for the poor, who begin to break out of poverty as soon as the economy is reactivated, but are the first to feel the impact when economic activity suddenly contracts.

II. *Where we are going: looking ahead*

A. Institutional challenges

The balance of achievements and frustrations as we enter a new decade raises new challenges for the Bank stemming from the changes that occurred in the local economies of the countries in the 1990s and from increased globalization, along with demand on the part of governments and public opinion that the role of multilateral development banks be reviewed. We must bear in mind that the role the Bank should play in the coming years needs to be examined in light of the objectives established by the governments of the member countries, but at the same time affirming the origin and historic significance of the Bank, with an understanding of its responsibility to plan and address its future.

For purposes of internal discussion, these challenges can be identified as follows:

- the role of multilateral development banks in the new international financial architecture and the debate on this issue in both the borrowing and nonborrowing countries, as well as in public opinion;
- the role of the Bank with respect to the changing needs and demands of the countries in the region and the ever-increasing heterogeneity of their economic and social structures;

- the need for the Governors to reaffirm and deepen the mandates of the Eighth Replenishment, in light of the above-mentioned challenges;
- timely updating of the Bank's "instruments" for cooperation with the countries in the region; and
- preservation, within a complex international context, of the regional nature of the Bank and its very identity as the development bank of Latin America and the Caribbean.

1. The role of the Bank in the international debate on the future of multilateral development banks

Over the past few years a healthy, active discussion has developed on the role of multilateral development banks (MDBs) in the committee meetings of the Bretton Woods institutions.

The role of MDBs in relatively less developed countries has been discussed as part of the Heavily Indebted Poor Countries (HIPC) Initiative, in which MDBs and donor countries have actively participated, and also as part of the preparation of the poverty reduction strategies, designed to be key policy instruments to link debt reduction for eligible countries with a frontal attack on poverty.

A new chapter in the discussion is now opening: the role of MDBs in middle-income countries (MICs). We have been following the debate with the technical teams of the World Bank in dialogue with other development institutions.

Based on the papers and reports available, we can summarize the positions of the country groups along the following main lines:

- For the developed countries, the role of MDBs should be reviewed as a response to the problems of poverty, governance, coordination among MDBs in the system, and pricing policies in MDB management. As for MDB operations, the main questions

raised revolve around the provision of global public goods, financial sector reform, and support for good governance, among other issues.

- For the borrowing countries, the main concerns are to expand MDB cooperation given the new needs that have arisen, especially as a result of globalization, support for crisis prevention and mitigation policies, improved public spending, creation and strengthening of social safety nets, the catalytic function of stimulating private capital inflows, and cooperation for integration. Ultimately, the essential concern of middle-income countries is that MDBs assume a countercyclical role, as opposed to their approach to date, so that their policies and lending instruments can be used to help the countries to solve traditional development problems and the new problems stemming from both domestic policy and the international economic situation.

2. The role of the Bank in addressing the new needs and demands of the countries in the region

The Bank should seek to understand and address the needs and aspirations of all its member countries, recognizing the special identity of each one. As I mentioned earlier, the new needs for Bank cooperation with its member countries have grown out of the problems that concern the countries at the dawn of the new millennium, resulting from the balance of achievements and frustrations bequeathed by the nineties.

- ***Social vulnerability*** has arisen in particular from the poverty, inequality, unemployment, and exclusion referred to earlier. Social protection policies are crucial for a head-on approach to education reform.
- ***Economic vulnerability*** results from the low growth rate and low investment and savings. Among the priority areas of activity in this connection are reform of the productive system to increase competitiveness and develop capital markets.
- ***Institutional strengthening*** is linked to good governance in the broad sense, implying reform of the State and participation by civil society. Good governance

should be reflected in solid, efficient, transparent, accountable institutions, without which sustainable comprehensive development will not be possible.

- ***External vulnerability*** is linked in particular to the low quantity and quality of exports. It should be noted that priority therefore needs to be assigned to integration, the central thread of the Bank's action since its inception, and to cooperation for initiatives for the region to join larger trade blocs.
- ***Environmental vulnerability*** is due to poor management of natural resources and exceptionally high rates of urban expansion. Both are factors in regional development and should prompt action by the governments and the Bank.

The concerns raised by the two groups of countries are being addressed through improved institutional governance of MDBs, especially by strengthening rigorous independent evaluation systems and improving coordination between the Bretton Woods institutions and the regional development banks through the exchange of information, joint projects, and harmonized assessments and conditionalities. MDBs are also seeking closer ties with the United Nations system.

3. Reaffirming and deepening the Eighth Replenishment mandates

As I mentioned earlier, under the Eighth General Increase in the Resources of the Bank, the Governors established a series of clear, precise objectives for the Bank's activities in support of economic and social development that remain fully valid as we enter into this new decade.

The Eighth Replenishment mandate was for the Bank to focus its activities on ***reducing poverty and inequality, modernization of public and private institutions, integration, and the environment.***

The Governors should now decide whether they need to reaffirm and stress certain specific areas among the priorities established under the Eighth Replenishment, in light of the current problems in the region. The Board of Executive Directors decided to undertake a study of the new circumstances that warrant reaffirming and strengthening the objectives for

the Bank's activities as set in 1994. Since 1998, Management has prepared a number of discussion papers submitted to the Board of Executive Directors and the Board of Governors for consideration. The new institutional strategy was prepared jointly by the Board of Executive Directors and Management in 1999. The Board approved the strategy and has organized special meetings to discuss the matter, based on which future recommendations will be made to the Board of Governors.

In my opinion, the core objectives of the Eighth Replenishment remain fully valid and should be specifically reaffirmed.

- ***Reducing poverty, inequality, unemployment, and exclusion.*** Regardless of the moderate growth rates achieved, the region can carry out massive poverty reduction programs so that the *international development goals* could be reached faster than in other regions. Successful experiences such as the PROGRESA program in Mexico and the “Bolsa Escola” program in Brazil are good examples of what we should affirm.
- ***Modernization of public and private institutions.*** These two objectives, which find new expression in activities to improve governability and competitiveness, are critical to accelerate growth. It has been demonstrated that a vigorous growth rate helps reduce poverty. Depending on the attendant policies, that impact can be greater and enduring, but social problems will not be resolved in the long term if growth rates do not increase faster.
- ***Integration*** remains a fully valid focus, and in fact should be expanded given the current phenomenon of globalization of the regional economies.
- ***Environmental protection*** continues to be a central, cross-cutting objective in the activities of public and private institutions and of our Bank in particular.

There are also other special areas of activity that the Board of Executive Directors and the Board of Governors should examine because they are consistent with the spirit of the

Eighth Replenishment and particularly relevant given the current situation of the economy and societies in the region.

The additional areas that should be assigned priority include the following:

- ***Reactivate support for both economic and social infrastructure.*** This traditional area of activity of the Bank should be strengthened in light of new development demands, especially integration. The Bank cannot and must not lose its basic commitment to these areas of cooperation with the region that have been the mainstay of its work in Latin America and the Caribbean throughout its history.
- ***Strengthen social safety nets,*** an activity which has proven to be an effective instrument to fight poverty. After social safety nets, support for microenterprise is particularly important, and the Bank has considerable experience in that area.
- ***Outreach for citizen participation*** in channeling resources to resolve social issues. The Bank must build bridges of cooperation between the State and civil society, especially in the areas of poverty reduction and employment.
- ***Create an enabling environment for private-sector development,*** especially national and regional capital market development, and establishment of clear, transparent regulations for market operation. Special attention should be paid in this connection to providing support for small and medium-sized enterprises.
- ***Continue to support financial system reform,*** particularly the institution of international standards for best practices in banking and measures to prevent money laundering.
- ***Identify regional public goods*** that the Bank should support, such as environmental protection, joint action against regional endemic diseases, and opportunities to support education through programs based on intensive use of new information technologies by countries at the regional or subregional level.

- *Use information technology* in such activities as education, health, governance, support for small and medium-sized enterprises, and generally all activities where use of such technology will help increase equity in our countries. We also need to determine how the Bank can contribute to a decisive effort to close the technology gap in our societies between those who have access to information technology and the vast majority of citizens who do not.

These are some of the fronts that should be evaluated in the process of reviewing and deepening the objectives of the Eighth Replenishment.

To illustrate these problems, Management presented a paper to this meeting entitled *Institutional strategy implementation. Report to the Board of Governors*, which discusses certain considerations in the Bank's objectives for this decade.

This document, along with the previous ones, can be used as the basis for an internal debate in the Board of Executive Directors that will lead to recommendations to be submitted to the Governors. Over the coming months, this process should result in the reaffirmation and strengthening of the Bank's objectives for the coming decade, based on the parameters set forth under the Eighth General Increase in Resources.

4. Updating the Bank's available instruments

In recent years, attention has focused on the Bank's difficulties in achieving an annual lending volume close to the sustainable level that its capital stock allows and that ranges between US\$8 billion and US\$9 billion. The World Bank has been experiencing a similar situation. In the past few years, our Bank has only reached its full lending capacity when special loans had to be granted to address financial crises in order to contain and resolve financial contagion and market volatility.

What could explain this lack of demand for Bank loans for public investment on the part of middle-income countries?

The explanation lies in a combination of mutually reinforcing factors:

- Privatization programs have diverted the governments from traditional investments in infrastructure, which are now covered by the private sector. This factor also explains the pronounced demand for private-sector loans, particularly in the energy and transportation sectors, as well as certain social sectors, such as water supply.
- The economic adjustment policies adopted to address these external crises and the new fiscal responsibility measures taken by the governments, often stemming from legislation enacted by the legislatures, have imposed caps on public debt that limit the amount of domestic and foreign debt that can be assumed.
- Those same budgetary constraints prevent or delay the local counterpart contributions required by the Bank for its projects, according to the foreign exchange financing matrix established by the Governors, thereby limiting the countries' capacity to absorb previously authorized external resources or fresh ones.
- In the less developed countries, the Bank has accrued a high outstanding balance in its favor, which makes it difficult to increase the flow of funds to those countries beyond the amounts authorized in recent years. It should also be recalled that the countries eligible to receive soft loans are constrained by the availability of concessional resources from the Fund for Special Operations, as well as by their internal capacity to absorb additional resources.
- Lastly, we must not overlook the fact that in some cases when the conditionalities for Bank loans are excessive or when the procedures followed for their processing are too bureaucratic, they become a disincentive for the countries to turn to the Bank when they need funding. In addition, they make implementation of the respective programs more difficult. The loan conditionality system therefore needs to be reviewed to make it more realistic and operational, but without sacrificing quality and effectiveness in project impact on the economic and social development of the countries.

Clearly, as the countries gain greater access to private capital markets and establish their international creditworthiness, demand for Bank loans will decline, as a natural, healthy result of the development process.

This evolution will lead to medium-term changes in the relationship between the larger countries of the region and the Bank in the medium term. Although their debt with the Bank may decrease, those countries will still be attracted by the nonfinancial services the Bank can offer and will want to remain involved in the Latin American and Caribbean community, for which the Bank affords a special forum for cooperation.

In the meantime, there are areas in which these countries remain interested in obtaining financial and technical support from the Bank, such as the following:

- ***Social projects:*** For broad segments of their populations that include the poor, the governments can enter into intelligent, targeted partnerships with the Bank to tap its experience and research related to the problems of poverty. The Bank has been carrying out innovative activities in this connection and has been discovering creative, highly positive new areas of cooperation.
- ***Infrastructure:*** Demand for infrastructure financing has been stimulated by integrationist policies that are opening up opportunities for public investment and, especially, for private investment. The Bank's involvement in such programs is essential because it helps mobilize long-term resources through the private sector window and because it contributes to developing harmonized regulatory systems (for energy, transportation, the environment) throughout the region, generating a broad-based market, thereby creating new opportunities for domestic and foreign private investment and at the same time improving project quality.
- ***Support for pending reforms, especially in the financial sector:*** as mentioned earlier, priority should be assigned to providing support for the development of the yet-incipient capital markets in the region and adoption by the countries of international financial codes for best practices in banking and the fight against

corruption and money laundering. These areas of activity should have special priority in the middle-income countries.

- ***Local government reform:*** this issue is pending in most of the countries as a result of the decentralization of responsibilities under way. The Bank has been accruing considerable experience in this area that should be extended to most of the countries.
- ***Integration:*** the Bank should provide support for policies and investments linked to integration processes and to the region's ties within the Hemisphere and with the rest of the world.
- ***Emergency assistance:*** the Bank should provide support in emergency situations caused by financial market volatility, as has occurred in recent years. It should be noted, though, that it is not the responsibility of multilateral development banks to take an active part in resolving financial crises, which should mainly be dealt with by the International Monetary Fund. However, alleviating the impact such crises can have on the masses directly concerns development bank responsibilities. One of the main factors in the setback in the fight against poverty over the past few years has been the dramatic impact of recent crises on the standard of living of the working class, massive disappearance of small and medium-sized enterprises, and the resulting increase in unemployment.

Support for vulnerable groups during such crises by maintaining social spending and through policies designed to minimize their impact on the poor should be an area of activity for the Bank. Likewise, during the crisis alleviation process, the Bank should provide support for policy reforms that will help protect economies from the erratic behavior of the international financial markets or the lack of domestic policies (armor-plating policies).

In this context, we should ask ourselves:

- How should the various instruments the Bank currently has available be used to address the new realities and new demands from the countries?

- Are new instruments needed to ensure that the Bank has a useful presence in the region that will enable it to take countercyclical measures for its member countries, without affecting the quality of its projects and their contribution to economic and social development, as mentioned earlier?

These are two of the basic questions for a Bank in which 21 of its 26 borrowing member countries are considered middle-income countries.

This matter has been assigned priority by the World Bank and its Development Committee, and will be considered specifically by its Board of Governors at the next Committee meeting in April.

I would like to make a few comments in this connection. The basic instruments available to the Bank for cooperation with our countries are: dialogue, programming, IDB Group technical cooperation, lending, and coordination with other international organizations.

At this point, I would like to touch briefly on each of these instruments that the Bank has at its disposal.

- ***Country dialogue.*** Since the Bank's inception, country dialogue has always played a central role. Of particular note is the growing importance that dialogue with governments and dialogue with the private sector and civil society has acquired in the 1990s. Obviously, the depth and scope of such dialogue differs considerably from one stakeholder to another.

Dialogue with government takes place at different institutional levels ranging from the physical presence of the Bank's Country Offices, to develop an understanding and maintain continuous daily contact with the public and private sector, to the dialogues and encounters for reflection that we have been promoting in recent years with governments, the private sector, and civil society.

Direct dialogue with government at its different levels is also conducted from Headquarters through the institution's regional operations departments, its technical

departments, and periodic direct contacts between the President and Senior Management and national authorities.

The meetings between *new administrations* and Management, in which officials from the Country Office and Bank economists also take part, have proven to be a most useful and beneficial tool for the Bank and the members of the new government team.

Dialogues between governments and civil society to discuss social and economic issues were launched in 1994 by the Bank following the Eighth Replenishment. Experiences in different countries led to basic agreements which have been covered in several studies published by the Bank. Among development banks, the Bank has led the way in promoting dialogues of this kind to discuss social programs.

Also set in motion in the wake of the Copenhagen Social Summit was a dialogue focusing exclusively on a comprehensive social strategy that former Chilean President Patricio Aylwin has been carrying out with the Bank's Management in several of our member countries.

Our involvement in shaping poverty reduction strategies has brought us a wealth of experience that has been put to good account in assisting the countries to make their own decisions on mechanisms for collaborating with civil society on the priorities of social programs to combat poverty.

This would appear to be the right time to extend these initiatives to other countries in the region and a joint effort with the World Bank and the United Nations to pursue this task would be particularly useful and relevant.

- ***Country programming.*** The Bank's programming for each country is based on the dialogues as well as studies and analyses of the economic and social situation in each case. Regrettably, scant resources are allocated to economic and social analysis for the countries. The assistance we provide is still insufficient and could be expanded substantially, providing an invaluable service to the countries in understanding their problems and helping to devise solutions. Country programming is also an

opportunity for making a constructive contribution to major areas of government action, particularly in the social sectors and governance.

- ***Technical cooperation with the IDB Group*** is one of the most useful tools available to the Bank, and was perceived as such by the institution's founders when they included technical cooperation in the Bank's Charter.

We are also in a special situation in which the basic support function performed by the Multilateral Investment Fund (MIF), in conjunction with the institution's major objectives, particularly improving governance, training, and the fight against poverty through support for development of the private sector and microenterprise, has become a tool used with increasing frequency in its member countries.

Technical cooperation is also an extremely useful tool for enhancing project quality and working through projects to transfer to the countries the best practices and considerable experience the Bank has gained through its presence in the countries.

To overcome some of their funding constraints, member countries have increased their borrowing from the Bank in order to be in a better position to receive nonfinancial advisory services.

- ***Lending***. We believe that the review of the Bank's different lending modalities should be conducted in light of our countries' needs and the Bank's cooperation objectives. Such a review should start with the set of support instruments it already has available.

To this end, the Bank's Management is delivering to the Governors a document analyzing the various alternatives that would permit innovative uses of these instruments, including discussion of the Bank's ***financing matrix*** which covers the lending caps for the different country groups and counterpart funding requirements. This initiative has been evolving since the 1960s and provides for different percentages depending on a country's level of development and the type of lending concerned.

We are not making concrete proposals here; we are simply affirming the concept that making some of the Bank's operating parameters more *flexible* and delegating them to the Board would be highly desirable if the Bank is to have the wherewithal to meet the new development demands of its member countries.

In 1994, the Governors foresaw the need to adjust the operating parameters established in IDB-8 and recommended that the financing guidelines and modalities be reviewed periodically. What is on the table is therefore not just the need to make adjustments in a number of operating parameters but to determine the most efficient and reasonable way of ensuring that:

- the Bank never loses sight of the purpose for which it was created: to help accelerate economic and social development in its member countries individually and collectively;
 - this objective is consistent with the instruments and mandates under which it operates; and
 - the Bank's financial standing is safeguarded.
- ***Coordination with other international organizations.*** Since the early 1990s Management has been coordinating its efforts with the Bretton Woods institutions through an ongoing relationship between Senior Management and the technical teams with which it keeps in touch with respect to the activities in each country and the general problems in the region. These contacts involve information exchanges, joint missions, and even cofinancing for joint projects that are considered directly by the boards of directors of the two institutions. When appropriate, officials from the International Monetary Fund are invited to report to our Board on economic conditions in the countries.

This relationship could and should nevertheless be intensified by coordinating country studies and assessments, sharing the expertise of officials in each organization, analyzing comprehensive policies on poverty, governance, etc. This concerted effort has become even

more pressing and urgent given the budgetary constraints under which both institutions are working.

Our relationship with the United Nations is still weak, with the sole exception of the United Nations Development Programme. I believe that new opportunities for working together are opening up to make the most of the comparative advantages of each institution.

5. Preserving the institution's regional nature

We have said repeatedly that the Bank is the product of the spirit of solidarity and regional and hemispheric cooperation that inspired its creation.

We can conclude therefore that in addition to addressing the fundamental objectives shared by multilateral development banks, the Bank should remain faithful to its regional priorities and promotion of this spirit. This certainly does not mean fostering an introspective vision of regional development that has been superseded by the facts, but rather making such cooperation an additional tool for development policy, thus facilitating more rapid and more creative integration of Latin America and the Caribbean into the hemispheric and global economies.

Protecting this regional nature assumes deepening the sense of ownership of the Bank by its borrowing countries, one of the Bank's greatest assets.

Against this background, the regional vision also assumes that the Bank will continue to be highly committed to regional cooperation in its broadest sense. This involves dealing with arrangements for integration as well as cooperation between countries and country groups in all its forms, including support for trade negotiation mechanisms with other economic blocs.

Cooperation for developing physical infrastructure is an important facet of this loyalty to the Bank's roots. That is why we stand firmly behind the South American initiative of the President of Brazil and the President of Mexico's initiative for Mexico, Central America, and Panama under the Puebla-to-Panama project.

Cooperation to strengthen regional integration mechanisms includes harmonization of economic policies, border development, and monetary and financial cooperation.

Other aspects include regional cooperation on the use of information technology to support regional and subregional education, health, and governance programs as well as programs to support small and medium-sized businesses through regional or subregional networks.

In addition, we need to have cooperation between different areas of the private sector at the regional and subregional level, including capital and securities market development.

B. Conclusions

Management has submitted to the Board of Executive Directors and to the Committee of the Board of Governors for consideration the documents referred to in the annex attached to the transcription of this speech.

The need for greater flexibility is the common theme raised in all four documents. To accomplish the development objectives established under the Eighth Replenishment and to continue to be relevant and effective as an institution calls for flexibility in our policies and operating procedures and processes, while ensuring that transparency and probity in institutional management is maintained. Flexibility will also be required for the Enhanced HIPC Initiative to be implemented.

The objective of making the institution more flexible is inextricably tied to the goal of increasing the rigor and depth of the diagnostic assessment, analysis, and evaluation of the results of the Bank's action. The operating parameters have not only served as guidelines in allocating the Bank's resources but also as ceilings or oversight mechanisms that we believe need to be reviewed. Making these parameters more flexible could help to place the Bank's lending program more in line with the needs of the countries and to address their role as control variables. In other words, the overriding objective of increased flexibility is to maintain the relevance, timeliness, and effectiveness of Bank-supported development activities, but it also calls for a rigorous system of strategic programming and performance

evaluation. However, it will not be an easy task to strengthen the system to measure the benefits of our activity in isolation from the actions and decisions of the countries and other development agencies.

This is a daunting undertaking since it involves more than just using more rigorous standards to gauge the Bank's efforts. First and foremost, it is an attempt to measure results that are only partly under our control, only partly attributable to our presence. We are committed to our countries embracing the idea that the development of more productive and competitive economies, societies that are more just and integrated, requires a strategic vision on the part of political parties and governments. These strategies will be tailored to the needs of each country and will be based on the experience and history of each society, but they will help to chart the long-term course that we wish to pursue, and the targets for achieving it. The essence of the Bank's strategic programming is to bolster national efforts to achieve the development goals identified. This calls for the Bank's support for investment programs, the benefits of which will materialize in the medium and long terms, as well as bridge loans whenever necessary so as not to jeopardize the long-term objectives.

It is our hope that these reports and the considerations outlined in this message to the Governors will serve as a basis for reflection by the Board in the months ahead. The outcome would be used to underpin the discussions that the Committee of the Board of Governors may hold on the Bank's position in the international debate on the role of multilateral development banks, ratification and prioritization of the Bank's objectives for the next decade, and the analysis of the new instruments that could help support these policies of the Bank's.

To conclude, we would like to raise the following points for consideration by the Governors.

- The present international discussion on the role of multilateral development banks is timely and necessary, and the Bank should assume a clear-cut position for active, constructive participation in this debate by the Governors.

- The review of the Bank's role at the beginning of the decade is indicative of its influence in the economic and social reforms that took place in its member countries during the 1990s and the impact of globalization on economies in the region. All of this together has led to renewed demands for Bank action.
- The objectives-based review of what could be considered a new agenda for cooperation should be based on ratification of the objectives established by the Governors at the time of the Eighth Replenishment and in the deepening of some objectives in areas justified by changing conditions and requirements in the countries.
- The objective of a frontal assault on poverty, expressed in the Eighth Replenishment document, should continue to be the pivotal theme in our activities and part of an ambitious agenda for social development, embracing efforts to achieve equal employment opportunity and to mainstream the segments of society bypassed by economic and social progress.
- The objective of modernizing public and private institutions expressed in the Eighth Replenishment has a new view of the problems of governance and competitiveness. *Good governance* is an inescapable objective of any structural reform in our countries and of their development policies. Competitiveness is a basic tool for achieving faster and better quality economic growth, without which genuine social development would not be possible.
- *Integration* lies at the very heart of the Bank's activity and is now a fundamental objective of individual and joint initiatives in the countries. This objective should be of top priority in policies on institutional cooperation.
- Environmental concerns should continue to motivate building a comprehensive agenda for sustainable development for countries in the region.
- New fronts for the Bank's action have emerged from the above-mentioned considerations and should be targeted, protected, and accorded priority by the Governors.

- The Bank now has an array of instruments that were approved by the Committee of the Board of Governors. More flexibility for the Board of Executive Directors would be highly desirable. The natural counterpart of such flexibility would be a performance-based evaluation conducted by Management for the Board and the Governors.

- Throughout this entire exercise we must not lose sight of our institution's unique comparative advantages built on forty years of experience in the region. These advantages include a sense of ownership on the part of the borrowing countries, frank, open, ongoing contact with governments and the public and private stakeholders in the development process, an underlying commitment to social issues, governance, integration, etc. Any reform should maximize these advantages, which are the institution's greatest asset.

As we have said before, the Bank's work is relevant. And this relevance can only be maintained if the Bank is successful in helping the countries resolve the problems that they are bound to encounter amid the new national and international conditions.

National and regional relevance would also enable the Bank to properly address major global objectives, particularly the move towards a new international financial architecture. In fulfilling its objectives, the Bank cannot and should not neglect its commitment to the international financial community and its greater objectives, particularly those stemming from the institution's meaningful contribution to *common public goods* to which world public opinion is being sensitized.

This paper is just an opening salvo on what we hope will be a broad-based discussion with the Board and subsequently the Governors in the months ahead. Attached to the transcription of this speech is a summary of Management's reports to this Committee of the Board of Governors.

Management's contribution to the Committee of the Board of Governors

Given these challenges to development, and based on the evolving needs of the member countries, Management set out to study the factors impeding optimal use of our financial and technical capacity and to determine how we can improve the effectiveness of our assets to serve development. Management has submitted four reports to the Board of Governors for consideration. The reports cover issues that are inextricably interlinked.

- A progress report on the *implementation of the institutional strategy* sets out the methodology that the Bank would use to achieve the objectives of poverty reduction and sustainable growth outlined in the Eighth Replenishment document, and to organize its work in each of the four priority areas (document GN-2077-7).
- A document on lending policy issues, based on discussion of two of the parameters established by the Governors in the Eighth Replenishment document, proposes caps on financing in foreign exchange for Bank projects (the *foreign exchange matrix*), and a breakdown of *policy-based* lending operations (document GN-2146) and investment lending. The document stresses that (i) the Bank's guidelines and operating modalities should be adjusted to meet the countries' new social and economic development needs, and (ii) the Governors should entrust the Board with the task of reviewing these operating guidelines and parameters periodically to make them more flexible, and to ensure they are consistent with institutional objectives.
- A document on private-sector lending proposes an increase in the *cap on private-sector loans without sovereign guarantees to the equivalent of 10% of the Bank's outstanding loan portfolio*, excluding loans granted under the financial emergency lending program, but including the net value of guarantees on reinsured amounts (document GN-2144).
- A progress report on the *Bank's participation in the Enhanced Highly Indebted Poor Countries (HIPC) Initiative* (document GN-1970-26).

Institutional guidance system

The Bank has traditionally had an institutional guidance system consisting of three main elements: (i) the *Agreement Establishing the Inter-American Development Bank*, setting out the Bank's ongoing objectives; (ii) the *periodic agreements on increases in the resources of the Bank* negotiated among the member countries and stipulating the Bank's priorities over a multiyear period; and (iii) the *normal decision-making process* carried out in the Board of Executive Directors.

The *Bank's Charter* states that the Bank's overall purpose will be to contribute to the economic and social development of the regional developing member countries, individually and collectively. The Eighth Replenishment (IDB-8) identified the *key areas* of Bank activities mentioned earlier (a) poverty reduction and social equity, (b) modernization and integration, and (c) the environment. Despite the time that has elapsed, these issues are still extremely relevant. Every loan proposal or Bank-sponsored activity must answer two fundamental questions: first, how are we contributing to environmentally sustainable growth, and second, how are we contributing to poverty reduction and social equity?

In order to strengthen the Bank's strategic planning capacity and equip it with flexibility and efficiency to fulfill the mandates of the Governors and respond promptly through the services it provides to the demands of the countries in the region, in late 1999 the Board of Executive Directors considered a strategy paper entitled *Renewing the commitment to development. Report of the Working Group on the institutional strategy* and approved its recommendations (document GN-2077-1). This document consolidates a series of guiding principles and initiatives considered essential for prioritizing the Bank's activities.

The institutional strategy identified the need to adopt an approach that enabled the Bank to concentrate its efforts in areas where it has a comparative advantage over other multilateral institutions. These areas include (i) social sector reform, (ii) modernization of the State, (iii) competitiveness, and (iv) economic integration.

The Bank's activities in these areas were described in greater detail by the President of the Bank in his report to the Eightieth Meeting of the Committee of the Board of Governors

(The Region at a Crossroads: Some Thoughts on the Bank's Response to Development Challenges Today, document CS-3258) and by the Chairman of the Working Group on the institutional strategy in the report he presented at the same meeting.

The Bank's achievements since IDB-8

Given the changes that have occurred worldwide and in each country since the IDB-8 negotiations, it might be useful at this point to review a number of operational matters.

The paper titled *Lending policy issues* (document GN-2146-1), presented by Management to the Board, reports on the headway made by the Bank in fulfilling the Eighth Replenishment mandates. Generally speaking, the topics have been addressed by Management with the results indicated in the document. Some of these I would like to point out in particular.

Since IDB-8 was approved, the Bank has become the main source of multilateral financing for the region. It is pursuing an innovative and diversified lending program that emphasizes poverty reduction, social sector development, modernization of the State, and the expansion of basic infrastructure. During this period, the Bank's regular lending program supported 513 projects for a total of US\$42.3 billion. Public sector investment loans at US\$32.3 billion accounted for the lion's share of this lending, and US\$2.4 billion went to the private sector. Programs to support policy and institutional reform totaled US\$7.6 billion, representing 17.9% of total lending between 1994 and 2000. In addition, the Bank approved nine loans under the emergency lending program totaling US\$7.6 billion (nearly all disbursed) to meet the needs of countries adversely affected by the 1997 financial crises in Asia and in Russia. The less developed countries in **Group II** received 33.5% of all regular lending.

On the **social front**, in accordance with the poverty reduction and social equity targets, 43.7% of all projects and 42.1% of all regular lending was for social activities, exceeding the IDB-8 target. More important still is the fact that the Bank substantially expanded its action in the social sectors, not only in traditional areas such as human resources development in health and education, but also in new sectors ranging from women's issues

and indigenous community development to support for SMEs, low-income neighborhood improvement, and urban and domestic violence.

The borrowing countries recognize the Bank's presence in these areas. I would like to highlight the support being provided for the design, financing, and evaluation of social safety nets through special loans to offset the impact of adjustment and the extreme vulnerability of our economies to external shocks.

In the area of *competitiveness*, the Bank's action has concentrated on regulatory reform, financial reform, opening up of the export sector, reform of the justice system, reform of the State at all levels, and SME and microenterprise development. The Multilateral Investment Fund has proven to be an invaluable instrument for broad-based technical-cooperation initiatives in these areas, particularly public-sector reform.

Of particular significance has been the support for *integration* through mechanisms to promote subregional trade and to address the new challenges of bringing Latin America into the North American and the European markets.

Efforts have been made to strengthen *environmental protection* in all of the Bank's operations and to provide support for environmental initiatives such as the Pantanal, Darién, and Petén projects, which are particularly important for the region. In each case, innovation was achieved through participation of the social sectors and transparency in informing public opinion.

With respect to the *private sector*, the Bank has been consolidating its activities through human resources development and the growing presence of its private-sector window in the region. The business community is expressing increased interest in gaining access to this window, clearly demonstrating the progress made and significant demand in the years ahead.

Updating the Bank's instruments

Given its institutional objectives and the changing conditions in the countries, a review of the Bank's financing instruments, policies, and procedures has become necessary

in order to make them consistent with its objectives. This undertaking began in 2000 with the approval by the Board of five new instruments designed to: (i) minimize administrative costs to the Bank and the countries and the lead time for loan operations; (ii) provide for multiphase financing to support the development of specific sectors over longer terms; (iii) improve project preparation and execution; and (iv) foster innovation and experimentation, two dimensions that are essential in loan operations for the social sectors.

Management is considering *additional instruments* that take into account the needs of countries in the wake of reform of the State, the changing role of national governments in the economy, and the division of responsibilities between the central and local governments, which are critical aspects in the design and execution of Bank-financed projects and programs. Accordingly, the traditional investment financing instruments available to us must be reviewed in order to adapt them to the needs of our countries, taking into account the institutional capacity and performance-based management capacity of the different executing agencies and borrowers.

Policy-based lending (PBL), introduced under the Seventh Replenishment, was broadened under the Eighth Replenishment to include financing for reform programs, the costs of which were basically budgetary. The use of these instruments for reform programs in the areas of education and health, the restructuring of national pension and retirement funds, and certain financial sector reform programs transformed them from external adjustment instruments during the Seventh Replenishment into internal and external instruments under the Eighth Replenishment. However, the authorized cap was lowered from 25% to 15% of total lending volume for the IDB-8 period, since PBL was expected to decline. By the end of 2000, PBL accounted for 17.9% of all regular IDB-8 lending and demand for it is expected to remain high. The preference that countries have shown for PBL is linked to certain conditions that should be highlighted: disbursements do not limit eligible expenses and do not require counterpart funding, and administrative costs of executing units are significantly lower.

The *foreign currency matrix* is the percentage of a loan that the Bank can provide in foreign exchange to cover the total cost of a given project. The matrix currently ranges from

50% to 80%, depending on the country group, plus an additional 10 percentage points for projects that qualify as poverty-targeted investments (PTI). Maintaining the matrix within a percentage range is still a valid methodology for interpreting and applying the Bank's Charter and policies. However, greater flexibility is needed because of the many changes that have occurred in the borrowing countries, in the breakdown of Bank lending, and in the practices of other international financial institutions.

Experience in developed countries has shown a link between per capita growth and stock of infrastructure. In Latin America and the Caribbean, infrastructure is inefficient and in short supply, leading to bottlenecks that impede the recovery of sustained growth. Not only does investment in infrastructure affect the growth rate, it can also have a significant impact on the development of national capital markets. Our challenge is to link infrastructure investment in Latin America and the Caribbean to the development and integration of local capital markets in other parts of the world. That is the challenge facing the Bank and its member countries.

Given the still limited financing available in the countries, and the embryonic phase of local capital market development, stemming from mutual funds and national private pension funds set up as a result of social security reform, the Bank—as a financial institution with a wealth of experience and long track record in the region that is well regarded in the markets—is becoming powerful in leveraging private resources and alleviating the political risk for investors. Over the past five years, the Bank has leveraged on average \$6 of investment for each dollar it has invested in loan and guarantee operations.

The proposal to expand the private-sector window contained in the *Response to the External Review Group's report on private-sector operations* (document GN-2144-1) is based on an overall evaluation of the role that the Bank has been playing in the region and the experience that countries in the region have had with private-sector lending and guarantee facilities. Although the Bank's private-sector loan portfolio is still small, the review of its first five years of operations conducted by the Bank's Office of Evaluation and Oversight found the portfolio had had a positive impact on development and was financially sound.

The Bank established the *External Review Group* to examine the performance of the Private Sector Department since its inception and to recommend a strategy and the scale of private-sector lending for the future. In its report, the Group urges the Bank to play a more visible role promoting private-sector investment in the region, especially through a prudent but substantial increase in private-sector operations without sovereign guarantees.

The Group recommended eliminating the 5% cap on private-sector operations altogether and replacing it with a flexible approach, whereby the level of such lending would be determined by the regular programming exercises in the countries. However, Management feels that a phased-in approach should be adopted in order to increase private-sector operations, with the cap on financing for the private sector raised to the equivalent of 10% of outstanding balances of loans and guarantees granted by the Bank, excluding emergency loans.

A measure to supplement the higher volume of Bank operations to finance investment in the region, that is consistent with the mandates of the Eighth Replenishment and the basic institutional commitments set out in the Bank's institutional strategy, is to mobilize as much financing as possible to support economic and social development in Latin America and the Caribbean. In this same vein, the use of political risk guarantees is the ideal tool to leverage private capital for reinsurance operations since this has a dramatic catalytic effect and presumably involves less risk for the Bank than private-sector loans without sovereign guarantees. To select reinsurance companies, Management will apply the criterion of high-quality commercial paper (investment grade). In approving the guidelines for these reinsurance operations, the Board of Executive Directors specifically asked the Board of Governors to provide guidance as to how to determine reinsured amounts with respect to the cap to be imposed for private-sector operations. Management is to prepare a proposal by August 2001 at the latest that will be submitted to the Board of Executive Directors for consideration. If approved, it will be forwarded to the Board of Governors.

Flexibility in rules and procedures

The phenomenon of globalization under way in Latin America and the Caribbean brings with it the internationalization of finance, trade, and technology and, inevitably, the need for an in-depth discussion of the role that the Bank should play if it wants to continue to be relevant as an institution for social and economic development and one of the region's main sources of multilateral financing. This discussion needs to take place among the Bank's partners, since the G-7 framework focuses on the Bretton Woods institutions. The two discussions are clearly complementary. Among the points to be determined are the comparative advantages of the different institutions, possible adjustments in their mandates, and the division of labor between them to prevent wastage of scarce resources. This, in turn, will call for greater coordination and cooperation with other donors and multilateral and bilateral agencies to avoid duplication of efforts and to promote the adoption of complementary measures.

Irrespective of the final outcome of these discussions, one inevitable conclusion is that although we are often unable to anticipate the signs of the times, it is essential to be at least prepared to address the challenges before us. This means that the Bank must become a considerably more flexible institution. In fact, globalization demands greater flexibility and adaptability not only on the part of the countries but also on the part of the Bank, if it wants to maintain its capacity to respond to the needs of its member countries.

In 1999, the Board and Management launched a joint review of the institutional and organizational framework the Bank needs so that it can continue to be relevant to the economic development of a region in the midst of sweeping changes. The institutional strategy paper reaffirmed the principles and objectives outlined in the Eighth Replenishment, and presented a judicious evaluation of fulfillment of the mandates together with a description of the region's changing needs.

The institutional strategy thus provided an overview of the programming and institutional requirements for the future and an approach to address them. Management has been working closely with the Board of Executive Directors to develop and implement the

action plan to implement the strategy, including the methodology that the Bank will use to achieve the objectives of poverty reduction and environmentally sustainable growth outlined in the Eighth Replenishment.

While Management is concentrating on identifying and streamlining rigidities in the Bank's products and services, it is our hope that during the year the Governors and the Board together can address the issue of making the Bank's response capacity more flexible in order to satisfy the development needs of its countries, thus making optimum use of its resources without detracting from the distribution of these services between Group I and Group II countries.

Rigorous analysis and performance evaluation

If the Bank's guiding principle is to achieve development objectives, then the central instrument around which its activities and actions are organized is the *strategic country programming*, and the *country papers*—which establish the specific development objectives—are the linchpins guiding the Bank's activities. Keeping these institutional objectives and financial policies and instruments consistent with one another is vital and calls for continuous monitoring and adjustment to maximize the development impact of the Bank's efforts while safeguarding its financial standing.

Identifying and monitoring specific development objectives will not only make it possible to take a more flexible approach to designing projects and programs but will also provide the Bank and the country with necessary information on the achievement of development objectives, a key component of the Bank's guidance system. To ensure that the Bank's actions are relevant, the work program in each country must reflect the priority objectives, the goals of the programs and projects must be in line with the objectives, the objectives must be realistic and attainable, and program supervision must continue to focus on the development objectives established.

The system guiding the Bank's work has indicators based on indicative targets and numeric caps, measurement of which has been the foundation of the evaluation of the Bank's efforts. Management must therefore report annually on their performance. The

institutional strategy paper proposes a management style that assumes reviewing “what is valued” as the product of the institutional efforts and “how it is measured”. Measurement of development impact is crucial to understanding whether the resources being used to produce the Bank’s technical and financial services are generating the expected economic and social benefits, making it possible to study the factors that might be eroding the utility effectively delivered to the beneficiaries. This approach assumes a joint effort by the countries through their institutions and agencies, and by the Bank through its projects and programs, already in progress.

The Bank’s goals in each country may be different from national goals. We would like to help identify these goals to build the consensus that is needed on the great national challenges, bringing civil society into the reform process, and working with central government institutions as the natural channels for reform of the State behind these common objectives.

We propose to define, by means of a process begun by the Board and Management, a series of significant measures to underpin the development goals and measures of effectiveness of the Bank’s strategy as far as inputs, implementation, and results are concerned. That is the task upon which we have embarked.