

A NEW ERA AT THE INTER-AMERICAN DEVELOPMENT BANK

Six Recommendations for the New President



Comité
Latinoamericano de
Asuntos Financieros
Latin American
Shadow Financial
Regulatory
Committee

New Demands from the Region Require a Fresh Response

- Over the last decade the demand for IDB's services has changed dramatically
 - Rapid growth in private capital flows
 - Policymakers' need to articulate their own vision (independent from Washington)
- But the region's challenges go beyond individual countries' solutions
- The IDB's mission of promoting inclusive growth is fully aligned with the region's most pressing needs
- A new President at the IDB presents an opportunity for reassessing the institution's role and reshape its products and services

Key Challenges in the New Era

- IDB's relevance for middle-income countries is at risk
 - They use capital markets in good times
 - In times of crisis, support from the IDB is insufficient
- Not enough resources and instruments to face a possible adverse international climate for LAC, due to global disequilibria
- Growing ideological divisions within LAC regarding the role of the market
- Political pressures and bureaucratic obstacles within the IDB

IDB's Strengths

- It's an institution owned by the region
- Adequate forum for cooperation between LAC and creditor countries
- Mandate that allows for the increase in operations with the private sector, unlike other IFIs
- Credibility as a promoter of regional integration and competitiveness
- Skilled and knowledgeable staff

Two Cross-Cutting Themes in this Report

1. More flexibility in processes and decision-making (because countries are different and times change)
2. Enhanced support to:
 - Market reforms oriented to inclusive growth
 - The private sector as an engine for growth

Six Recommendations for the IDB President

1. Support policy and institutional reform
2. Expand and modernize private sector operations
3. Help members deal with exchange rate risk and other risks, in part through actively managing IDB liabilities
4. Obtain a clear mandate with adequate financing for a serious regional integration program
5. Fully realize the IDB's potential as a regional knowledge bank
6. Get a mandate to help shape a new international financial architecture

1. Support Policy and Institutional Reform

The Issue

- Growth in LAC is constrained by loss of competitiveness relative to industrial countries and other developing regions
- Competitiveness is undermined by inadequate infrastructure, education and governance and inefficient labor markets
- The IDB is helping countries to strengthen competitiveness programs, but more is needed

1. Support Policy and Institutional Reform

We recommend:

- Remove quantitative restrictions on the use of Policy-Based Loans (PBLs)
 - Increases the flexibility of the Bank's operations
 - Acknowledges that the quality of reforms and policies is essential to growth
- Create a “hassle-free” loan for countries well along in the reform process and that prequalify by meeting certain international standards
- Provide countercyclical emergency loans with IDB's own conditionality. Consider offering pre-qualified countries a line of credit (similar pre-qualifications as in hassle-free loan)

2. Expand and Modernize Private Sector Operations

The Issue:

- Many factors hinder the funding of private projects in the region: market failures; excessive intervention of the state in fundamentally-private activities; regulatory, legal and corporate governance deficiencies.
- IDB's initiatives are making important, yet insufficient, contributions
 - Only 4% of loans in the IDB's balance sheet go to the private sector

2. Expand and Modernize Private Sector Operations

We recommend:

- Remove current quantitative restrictions on IDB lending to the private sector (cap of 10% of total assets)
- Commission (the President) an independent report on the costs of doing business with the private sector window of the IDB, and of possible inefficiencies from having 3 windows of lending to the private sector
- Consider establishing country-based institutions for supporting firms in the development and diffusion (as public goods) of technology

3. Help Deal with Exchange Rate Risk and Other Risks by Actively Managing IDB liabilities

The Issue:

- Sizeable currency mismatch in government's balance sheets are aggravated by:
 - Limited development of long-term financing in domestic currency
 - Missing markets to hedge currency risks
- The region would benefit if the IDB actively managed its liabilities to complete markets

3. Help Deal with Exchange Rate Risk and Other Risks by Actively Managing IDB liabilities

We recommend:

- Issue, when appropriate, in the international markets IDB long-term AAA bonds in local currencies. This could help the creation of a “benchmark yield curve” and develop financial instruments to hedge against foreign exchange risk. The IDB does not have to take risk in its balance sheet (e.g., channeling the resources obtained in local currency towards loans in local currency)
- Explore the benefits of developing markets for bonds indexed to a variety of variables including commodity prices or US economic growth
- Explore the provision of public sector credit guarantees denominated in local currencies

4. Obtain a clear Mandate and Financing for a Comprehensive Regional Integration Program

The Issue

- Regional integration in LAC, particularly of energy and transportation systems is poor and undermines the region's competitiveness
- To help address this problem the IDB needs to obtain from its shareholders a new, clear mandate and the allocation of significant additional resources

4. Obtain a clear Mandate and Financing for a Comprehensive Regional Integration Program

We recommend:

- New loan and guarantee products for multicountry investments by borrowers
 - Political insurance for investing in multicountry projects
 - Multicountry infrastructure projects where benefits do not accrue to the country where the investment is made
- A regional fund supporting integration through grants (at least partially)
 - Funded with contributions both from non-borrowers and from IDB's net income resources
 - Fund could finance projects such as regional prevention of diseases and plagues

5. Fully Realize the IDB's potential as a Regional Knowledge Bank

The issue:

- Countries could benefit from a more continuous interaction with IDB specialists
- Specialists with similar expertise are spread throughout the Bank, inhibiting the creation of a critical mass that facilitates institutional learning

5. Fully Realize the IDB's potential as a Regional Knowledge Bank

We recommend:

- Create Specialized Institutes at the regional level that generate and spread technical knowledge in areas where countries require continuous assistance (health, education, tax systems, auditing, etc.). These institutes should be able to work directly with all levels of national and subnational governments
- Charging for Technical Assistance services
 - have the “market discipline” guide the Bank’s activities in this area
 - eliminate financial pressures on the “spreads” charged in loans
- Strengthen the role of the Chief Economist in the development of ideas aimed at inclusive growth in the region, promoted by the IDB (especially regarding the international financial architecture).

6. Get a Mandate to Help Shape a New International Financial Architecture

The Issue:

- External volatility reduces the effectiveness of reforms and the capacity to finance inclusive social programs central to poverty reduction
- A central challenge for the IDB is to help countries cope with external volatility not only through emergency financing but by promoting the reform of the international financial architecture

6. Get a Mandate to Help Shape a New International Financial Architecture

We recommend:

- To serve as the region's voice, the IDB President needs to obtain a mandate for active participation in international forums where aspects of the international financial architecture are debated
 - Member of the International Monetary and Financial Committee
 - Member of the World Bank Development Committee
 - Participant: BIS, BASEL, G-8, G-20
- Active participation of the IDB in promoting and discussing instruments aimed at reducing contagion of financial problems in the region
 - One example is the “Stability and Growth Facility” for middle-income countries that comply with macro stability conditions and the MDGs
- The IDB President put back in the international agenda the discussion regarding the desirability of explicit rules for external debt restructuring

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