Recent Developments
at the
Inter-American Development Bank

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Introduction

I want to express my appreciation to Francois Gianviti, General Counsel of the International Monetary Fund (IMF), for his kind invitation to join you today. It is always a pleasure to participate in this very interesting annual seminar on current developments, offered by the IMF to the chief legal officers of the central banks of IMF member countries. I have been asked to share with you some of the salient recent developments at the Inter-American Development Bank (IADB or Bank), the largest and oldest of the so-called regional development banks. Those of you from Latin America and the Caribbean are certainly familiar with the IADB but for the benefit of the others, and also because the regional development banks are fairly similar in their basic structure, let me give you a quick overview of the institution I represent. I then will summarize a number of issues that have been at the forefront of discussion at the IADB within the past year.

Basic Information about the Bank

The Bank was established in 1960 and currently its shareholders are the governments of 46 member countries, consisting of 28 countries in the Western hemisphere, including the United States, and 18 nonregional countries, including most of the countries of Europe, Israel, and Japan. The purpose of the Bank is to further the economic and social development of the countries of Latin America and the Caribbean, primarily by providing long-term financing on favorable terms. At the end of December 2001, the Bank's total capital amounted to somewhat over US$100 billion, consisting of paid-in capital subscriptions by its member countries and callable capital subscriptions, available should there be a need to meet the Bank's obligations under its borrowings.

The Bank promotes the investment of public and private capital for development purposes and the orderly growth of foreign trade, primarily by providing loans for specific projects and to support institutional and policy reforms that will contribute most effectively to economic growth, and by providing technical assistance.

Under the Agreement Establishing the Bank, it is authorized to make or guarantee loans to its developing member countries or any of their agencies or political subdivisions, to any enterprise in the territory of such members, to development institutions or similar agencies of the members, as well as to the Caribbean Development Bank. With the exception of loans and guarantees that are made to the private sector pursuant to the mandate of the Bank's Board of Governors, as described below, the policy of the Bank is to make loans and guarantees only to the public sector (i.e., to member countries or inter-governmental entities or, with the full faith and credit guarantee of the member government concerned, to governmental or other public entities).

The Bank goes to the capital markets primarily to finance its operations. It has a AAA rating and borrows through public issuance or securities or private placements in different markets.

The Bank follows a policy of neither renegotiating nor taking part in debt rescheduling agreements with respect to its public sector loans. The Bank's loans cover only portions of the total cost of the projects it finances.

Most Bank loans are for specific projects. The Bank also makes policy-based loans in order to improve economic efficiency in specific sectors of the economies of its developing member countries and to promote sustainable growth by means of policy reforms. In addition, the Bank has a program of emergency lending for countries that are facing financial crises, which must form part of a macroeconomic stabilization program endorsed by and subject to the surveillance of the IMF.

The Bank also lends to private sector entities in the Region, subject to a number of requirements as more fully discussed below.

The Bank provides partial guarantees for debt financing designed to encourage private sector lending and investments. The partial risk guarantees and partial credit guarantees are provided mostly for infrastructures projects and may be offered on a stand-alone basis or in conjunction with a Bank loan. Guarantees may be made either without a government counter-guarantee under the limit for private sector operations as mentioned below, or with a government counter-guarantee.

A word about the Inter-American Investment Corporation (the Corporation), an institution affiliated with the Bank. The purpose of the Corporation is to promote the economic development of its regional developing member countries by encouraging the establishment, expansion and modernization of private enterprises, preferably those that are small -and medium- scale, in such a way as to supplement the activities of the Bank. Enterprises with partial share participation by government or other public entities, whose activities strengthen the private sector of the economy, are eligible for financing by the Corporation. In addition to making direct and indirect investments, the Corporation can provide technical cooperation, financial and general management assistance to Latin American and Caribbean enterprises.

Operational Mandates

Much like other multilateral development banks, the Bank has traditionally worked on the basis of periodic capital replenishments, in which the institution's shareholders agree to (a) the terms of increases of the authorized shares of the Bank and the subscription thereof during a specified period of time (usually four years), and (b) the priorities for the institution during the period of the capital increase. The last such increase approved by the Bank's shareholders was the Eighth General Increase in Resources of the Bank, approved in 1994 and to be made effective during the six-year period 1994-1999 (the "Eighth Replenishment"). Under the financial terms of the Eighth Replenishment, the Bank has the ability to maintain a sustainable level of lending of up to US$8 billion per annum.

The Eighth Replenishment specified certain areas of work priority for the institution. The Governors of the Bank specified the need to work on integration and competitiveness: the widening of markets through regional integration can make firms more competitive by taking advantage of economies of scale. Competition in national and regional markets helps to create the adaptability needed to compete internationally and fosters the development of dynamic and flexible organizations. In this regard, the Bank can use technical assistance and loan resources in support of national and regional efforts for: (a) promoting domestic and foreign private investment; (b) institutional strengthening and development of the infrastructure necessary for skills training and for technology generation and dissemination; (c) ensuring a friendly environment for small and medium-sized firms; (d) financial sector reform and modernization; (e) programs to provide necessary infrastructure in such areas as energy and transportation; and (f) strengthening and modernizing the agricultural sector.

The Governors also stressed the need for poverty reduction in the region. Reforms must support the broadening of social programs and guarantee full participation of all segments of the population, especially the poor, in productive activities, thereby promoting social and political stability. To bring about significant reduction in poverty levels the Bank supports the region in three closely linked areas: (a) the needs of families, women, and young people; (b) health and nutrition; and (c) human capital formation. The Bank's support of social programs and poverty reduction is aimed at reaching 40% of all loans and 50% of operations. The Bank's poverty-reduction programs must either be geographically targeted to beneficiaries who are poor, or the vast majority of its beneficiaries must be determined to be poor.

Further, the Governors agreed on the need to finance activities in the area of modernization of the state. While the private sector is becoming the main engine of growth in the region, it is necessary to continue building a more modern and effective State which is accountable and conducts its activities in a transparent manner. The Bank can help governments that request assistance in carrying out these tasks by supporting their efforts to: (a) achieve and maintain macroeconomic stability; (b) establish social sector policies and programs; (c) reform tax and budgetary systems; (d) modernize the public sector and move forward with the process of privatization; (e) strengthen public institutions; (f) strengthen the capacity to prepare and execute development programs and projects; (g) establish appropriate regulatory and supervision functions; (h) promote strengthening and modernization of the judicial system; and (i) support national parliaments. In general, the Bank supports the reform of democratic institutions, judicial systems and parliaments and the strengthening of civil society in all its expressions, including NGOs.

In the last two years, in the absence of the periodic forum for the Bank's shareholders (as represented in the institution's Board of Governors) to discuss the priorities of the institution and the mandates to be given to the Bank, Bank Management engaged the Boards of Governors and Executive Directors to jointly chart an institutional strategy that would guide the Bank in its operations, consistent with the mandates of the Eighth Replenishment. Accordingly, the four basic areas of work for the institution, are modernization of the state, social development, competitiveness, and integration. These four "pillars" of work, are to be done under the overarching objectives of (a) poverty reduction and social equity in the Region and (b) of supporting environmentally sustainable growth.

Measures to Enhance the Response Capacity of the Bank

After considerable discussion, the Bank's Board of Governors recently approved a number of guidelines intended to provide additional flexibility for the institution's lending operations. The Governors defined a lending framework with three categories of lending activities, each with its own objectives, purposes and financial terms and conditions. The amount of resources destined to "non-project lending" is increased. The implementation of the new framework is to be accompanied by specific measures to enhance the development effectiveness of the Bank's lending operations.

Investment loans remain the primary lending instrument for the institution, encompassing specific investment projects, global credit programs, institutional strengthening and technical assistance. The amount of a specific project that can be financed is increased and a three-year minimum disbursement period is established for such loans.

Policy-based (Sector) loans (PBLs), first approved as a lending instrument in the context of the Bank's Seventh Capital Increase approved in 1989, continues as such. Previously, the amount of total PBLs was limited by a specified percentage of authorized Bank lending. As part of the Governors' action, the amount of resources available for PBLs is limited by a specified nominal amount ($4.5 billion of ordinary capital lending over a 3 year period, beginning in January 2002 and $300 million of FSO lending over the same time period). Such PBLs must have clear objectives and measurable indicators to enhance development effectiveness, and a minimum disbursement period of 18 months.

A third category of loan operation, used on an exceptional basis in the past, is approved as a regular authorized lending instrument for borrowing member countries in unique crisis situations. An emergency loan is available for a particular country undergoing a financial crisis and as part of a macroeconomic stabilization program endorsed by and subject to the surveillance of the International Monetary Fund and, when appropriate, coordinated with the World Bank. Such emergency loans are designed to address the effects of international financial crises on the region's economic and social progress by mitigating the effects of a crisis on the poor of a particular country, protecting funding for social programs, and avoiding the reversal of policy reforms. Six billion dollars are available for such emergency loans on a revolving fund basis, without any specific time limitation. Disbursement periods are significantly shorter than in traditional bank instruments (usually less than 18 months) and the loans are available on market-based rates with a premium.

Private Sector Lending

One of the most important developments at the IADB has been the consolidation and expansion of the institution's lending program to the private sector without government guarantees. The Charter has always permitted lending to private sector entities in our borrowing member countries without a guarantee, and, in fact, the Bank engaged for a brief time in such lending in the 1960s. Such lending was discontinued for policy reasons. As part of the institution's Eighth Replenishment and subsequent action by member countries, the Governors authorized the Bank to lend or guarantee an amount eventually defined as five percent of total loans outstanding for private sector infrastructure projects.

The private sector lending program has proven quite successful. A 2001 review of the program by an external group of experts mandated by the Bank's Governors, recommended that a further increase in the maximum level of private sector operations be authorized. Thus, in December 2001, the Governors authorized an increase in the ceiling on private sector loans and guarantees to ten percent of the amount of loans and guarantees outstanding. In addition, the Governors authorized the Bank to direct private sector activities to the development of capital markets in its borrowing member countries. The Governors' approval was subject to a number of conditions, including the strengthening of management's private sector risk assessment capability, all of which the institution is implementing. The Governors asked for a review to determine the development effectiveness and additionality of private sector activities relative to other Bank activities in a period of three years.

With its expanded mandate, the Bank has actively engaged in private sector loan and guarantee operations, including activities in capital market development. With the ongoing crisis in Argentina and the restrictions that were imposed by the government, the program has experienced some difficulties with its portfolio in that country. The Bank is also moving forward with elevating the private sector risk assessment function to a higher level. In addition, the Bank has taken a number of measures to ensure that private sector activities supported by the Bank Group in each country (private sector lending financed by the Bank, private sector lending and investing financed by the Bank's affiliated institution, the Inter-American Investment Corporation, and equity investments and grant funding financed by the resources of the Multilateral Investment Fund, managed by the Bank) are properly coordinated with each other and with the Bank's public sector activities for that country.

Anti-money laundering activities

The last year has seen the Bank continue to provide financing for specific anti-money laundering (AML) programs in its borrowing member countries. Since 1998, the Bank has actively supported its borrowing member countries in their efforts at combating money laundering through the financing of national and regional programs. The Bank has provided such support within the context of its Governors' mandates to support the reform and strengthening of the legal and regulatory frameworks of its borrowing member countries. The Bank seeks to address weaknesses in the AML legal and regulatory framework, ineffective enforcement of AML legislation and of prosecution of money laundering offenses, deficiencies in existing financial intelligence units and the need to establish financial intelligence units where none exist, weaknesses in the banking and financial sectors, and inadequate regulatory coverage.

The Bank has approved the financing of a number of regional AML programs through technical cooperation grant funds. In each of these programs, the Bank has provided funding through regional executing agencies that have the political mandate to develop and promote AML policies and guidelines and to ensure that international standards and norms are applied uniformly in their member countries. Accordingly, programs have been executed and are in the process of execution through the Inter-American Drug Abuse Control Commission of the Organization of American States, and the two FATF-style regional bodies that exist in the hemisphere, i.e., the South American Financial Action Task Force that consists of nine countries of South America (GAFISUD), and the Caribbean Financial Action Task Force, that consists of 26 countries of the Caribbean Basin (CFATF). Activities that have been financed include training programs directed at banking supervisors and employees of regulated financial institutions in the detection of money laundering and programs directed at criminal prosecutors and judges in how to proceed with a criminal anti-money laundering case. Other activities that have been supported include programs for the establishment or strengthening of financial intelligence units and regional needs assessments.

National AML programs have also been supported through national lending and/or technical cooperation programs. All loan documents for projects and programs in the financial sector are required to include information on the member country's compliance with internationally recognized standards to combat money laundering and other financial abuses. All such loans should support any actions required to bring relevant AML legislation and institutions up to recognized international standards and should provide technical assistance and training as needed.

The Bank is also in the process of addressing recent concerns with respect to terrorist activities and the need to support the combating of the funding of terrorism (CFT). Bank Management has shared its concerns with the Board of Executive Directors and stressed to its operational and financial officers at headquarters and in its Country Offices the need to ensure that its controls, including the existence of Country Offices in each of its member countries and its disbursement and procurement guidelines, preclude any diversion of resources. The Bank's AML lending and technical cooperation activities could also include specific components designed to support national programs to combat the funding of terrorism.

It is also critical for the Bank to maintain close contact with international and regional AML/CFT organizations and to participate in the ongoing international dialogue on these issues. The organizations with which the Bank is linked have a political mandate to develop and promote AML/CFT policies and guidelines; ensure that international standards and norms are applied uniformly in their member countries; conduct periodic self-assessments and mutual evaluations of their respective national AML regimes, including legislation and practices; and report results to the organizations' membership. In the case of the regional FATF-style bodies in the region, the Bank has access to the periodic national AML regime mutual evaluations that are conducted and reported to the membership, which can be used by our Regional Operations Departments as a basis to identify AML needs that are eligible for Bank financing. The Bank is an observer and attends the periodic meetings of the FATF, the GAFISUD and the CFATF; it also has very close contacts with the CICAD.

Debt Reduction Support

During the year, the Bank agreed to participate in the enhanced Heavily Indebted Poor Countries Initiative (HIPC), a concerted, international initiative endorsed by the G-7, the International Monetary Fund and the World Bank, for addressing the debt problems of a group of countries identified as heavily indebted poor countries to ensure that reform efforts of these countries will not be put at risk by continued high external debt burdens. Under the HIPC Initiative, all bilateral and multilateral creditors are providing debt relief for countries that demonstrate good policy performance over an extended period in order to bring their debt service burdens to levels deemed sustainable.

For the Bank, HIPC debt relief will be for Bolivia, Guyana, Honduras and Nicaragua, and is expected to total a net present value of approximately $1.1 billion, delivered from 1998 through 2019. The debt relief is being implemented through, inter alia, a combination of write-offs of loans from the Bank's concessional window, the Fund for Special Operations, conversion of Bank-held FSO local currencies to convertible currencies, and grants of member countries through the World Bank HIPC Trust Fund.

Conclusion

I hope that I have been able to provide you with some information regarding recent issues that have been under discussion during the past year. The Bank faces interesting challenges as it moves ahead on its mission. There is recognition that more needs to be done to ensure that the institution moves from a culture of loan approval to a culture of results. Success in the outputs resulting from Bank activities is critical. It is also important to ensure that there is quality at entry of proposed projects into the Bank pipeline. Recent agreements with the Board of Governors require all projects to include quantifiable results indicators so that the institution can determine the development effectiveness of projects. The Bank is moving ahead in the establishment of a

Development Effectiveness Unit that will be dedicated to this important task. The institution's independent evaluation function, as embodied in the Office of Evaluation that reports directly to the Board of Executive Directors, has been strengthened.

Again, my appreciation to the International Monetary Fund for the kind invitation to join you today. I am happy to answer any questions that you may have.