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THE INTER-AMERICAN DEVELOPMENT BANK AND CHANGING POLICIES FOR LATIN AMERICA

Economic and political changes in Latin America, increased resources and new US policy towards the region have enhanced the Inter-American Development Bank's importance. Latin American governments now have the confidence to initiate and join in regional programmes. US interest has been focused on the region by its problems, including debts, drug exports, and the environment but also by the prospects for trade and investment. Both Latin American governments and, more recently, the US have encouraged the IDB to assume a new leading role. This Briefing Paper examines the history of the IDB and its problems in the 1980s and their resolution as background to its potential future role. Other Regional Development Banks will be treated later in the series.

When it was formed in 1959, the Inter-American Development Bank (IDB) had twenty members — nineteen in Latin America plus the United States. Today, it has 25 developing-country members in Latin America and the Caribbean, the United States and Canada, and seventeen 'non-regional' members including Japan, the UK and other major Western European countries (see Table 1).

Since its creation, the IDB has committed over $40bn in financial and technical assistance to the countries of Latin America and the Caribbean, of which $10bn was on 'soft', concessional terms. The total value of investment projects supported by the IDB, including the Latin American contribution, has amounted to over $120bn.

Until the 1980s, this multilateral agency could be described as an example of successful and innovative international co-operation, filling a distinct role. During its first 20 years, much of the IDB's lending was concentrated in agriculture and social sector projects (education, health, and urban development), while a large part of the World Bank's project lending in the 1960s was in support of infrastructural projects (e.g. dams and irrigation schemes). The IDB was in a better position to target the agriculture and social sectors, partly because of its greater local expertise and knowledge base, but partly also because of its willingness to experiment in areas it considered a priority. The approach of the IDB may have influenced other institutions, including the World Bank, during the 1970s when they focused more on agriculture and human resource development.

Despite these achievements, by the 1980s, when Latin America was facing economic problems on an unprecedented scale, the IDB had become administratively and politically weak. Its operational procedures were criticised as cumbersome, and its efficiency had suffered badly; the competence of its managers was questioned. The 'appropriate' response to debt or environment problems had become a matter of controversy throughout development agencies. Disagreement on these and other issues fuelled clashes between the US and Latin American members, particularly the 'big four' — Argentina, Brazil, Mexico and Venezuela — over the direction, and ultimately the political control, of the IDB. Lending by the IDB actually fell.

Since 1988 the Bank has acquired a new management, new funds, and prospects of a new role. Enrique Iglesias (former foreign minister of Uruguay, one of the smaller members) replaced a former Mexican finance minister who had directed the Bank for 17 years, as president. The principal managers were replaced. In 1989, a capital replenishment of $26.4bn was agreed, which allows the bank a lending programme of $22.3bn during 1990-3. In June 1990, President Bush announced his 'Enterprise for the Americas' initiative. This not only implied a major revival in US interest in the region, but would give the IDB a range of new responsibilities, including an investment fund of $1.5bn to administer, a role in supervising debt reduction funding, and possibly a share in plans for a hemispheric free-trade zone.

The IDB in the family of multilateral banks

The Inter-American Development Bank is part of the system of Development Banks. They provide substantial funding, technical assistance, and advice on economic policy. Pre-eminent and by far the largest is the World Bank, based in Washington. The three major regional lenders have been the IDB (also based in Washington); the African Development Bank (in Abidjan, Côte

Table 1
IDB members and voting power

Country	Percentage of votes
Regional developing members	
Argentina	11.59
Brazil	11.59
Mexico	7.45
Venezuela	6.21
Chile	3.18
Colombia	3.18
Peru	1.56
Uruguay	1.25
Bolivia	.93
Smaller members[a]	6.93
Sub-Total	**53.84**
United States	34.57
Canada	4.38
Non-regional	
Japan	1.08
Germany	.99
France	.97
Italy	.97
Spain	.97
United Kingdom	.97
Other non-regional members[b]	1.26
Total	**100.00**

a Dominican Republic, Ecuador, Guatemala, Jamaica, 0.63 each; Costa Rica, El Salvador, Haiti, Honduras, Nicaragua, Panama, Paraguay, Trinidad and Tobago, 0.47 each; Bahamas, 0.23; Guyana, 0.18; Barbados, 0.14; Suriname, 0.10.

b Austria, Belgium, Denmark, Finland, Israel, Netherlands, Norway, Portugal, Sweden, Switzerland and Yugoslavia.

Source: IDB Annual Report.

Table 2
IDB and World bank lending to Latin America (commitments) (US$m)

	1981-5[b]	1986	1987	1988	1989	1990
World Bank[a]	3,265	4,771	5,152	5,264	5,842	5,965
IDB	2,982	3,037	2,361	1,682	2,618	3,800

a. IBRD and IDA. Fiscal years to 30 June.
b. Annual average.

Source: World Bank and IDB Annual Reports.

d'Ivoire), and the Asian Development Bank (in Manila, the Philippines). The Caribbean Development Bank (in Barbados) is a much smaller 'sub-regional' bank, many of whose members are also members of the IDB. Belize, however, is excluded from the IDB because of opposition by Guatemala, and the Caribbean non-Latin American countries tend to play a minor role in the IDB. In April 1991 these banks will be joined by the European Bank for Reconstruction and Development lending to Eastern Europe (based, like the IDB, outside its region).[1]

Table 2 shows lending from the World Bank and the IDB which demonstrates the decline and recovery of the IDB. Its previous peak (in 1984) had been $3.6bn, with an average in the early 1980s similar to World Bank lending to the region. By 1988 it had fallen to less than a third the World Bank level. In all three regions, the World Bank is a more important lender than the regional bank, but the large difference is new in Latin America.

The International Bank for Reconstruction and Development (now with its affiliates known as the World Bank) was created in 1947. In the 1930s, as in the 1980s, many developing countries defaulted on their international debt during an economic crisis. Consequently, private capital ceased to flow to capital-starved regions. The collapse of long-term capital flows was one of three elements identified as international causes of the depression of the 1930s. The World Bank was created to prevent a recurrence of the collapse of international investment, along with the International Monetary Fund, to avoid short-term liquidity crises, and GATT (originally planned to be an International Trade Organisation), to prevent a breakdown in trading relationships. Its members are sovereign governments. Backed by public funds and government guarantees, the World Bank can borrow in the private capital markets by selling its own bonds, and then lend the money, with conditions, to finance investment projects.

The founders, the leading Western powers, effectively dominated the three new organisations. In the 1950s and 1960s, developing countries increasingly felt a need to forge new institutions in which their collective voice would prevail. One of the earliest was the Inter-American Development Bank, modelled on the World Bank but created to operate in Latin America, under a Latin American majority.

Latin America: from crisis to new confidence

The 1980s were a period of economic problems for many Latin American and Caribbean countries. Latin American countries saw their hopes of matching the performance of the Asian NICs dashed by heavy debt-servicing obligations, a collapse in the prices of their principal primary exports, and in demand in industrial country markets for all their exports, and internal economic instability, often accompanied by political instability, including military intervention or guerrilla movements.

Annual average growth of GDP in Latin America and the Caribbean between 1965 and 1980 of about 6 percent, compared to less than 4 percent among the Western countries belonging to the OECD, had made banks perceive the Latin American countries as good 'credit risks'. The debt problem erupted in 1982, when Mexico and Brazil declared a moratorium on their debt payments.[2] Per capita GDP, which grew 3.4% during 1965-80, fell at the rate of 1% from 1980 to 1990. A principal casualty was investment, which fell 5% annually between 1980 and 1990.

In the early 1990s, most have yet to restore the living standards enjoyed in the 1970s. Superficially at least, 1990 offered little evidence of economic revival, with output falling in Argentina, Brazil, Peru, and some smaller countries; Chile grew only 2%, and Colombia was the only large country to achieve more than 3% without special factors. (The temporary rise in oil prices raised Mexico and Venezuela to 4%.) Investment looked equally unpromising, falling in all these countries.

In spite of this, expectations for Latin America, by institutions outside Latin America like the World Bank and the UN, and within it, including both the IDB and the UN Economic Commission for Latin America and the Caribbean, are much more optimistic than they have been since the early 1980s. The reasons vary, but include the restoration of elected governments, implying popular support for new policies, changes in macro- and micro-economic policies, and the promises of more favourable US policies. The last, in particular, mean that many regard the debt problem as, if not settled, at least on a well-defined negotiating path to resolution, even if its consequences remain a burden on past and future investment.

All these have given governments and institutions the confidence to look at new policy initiatives.

The IDB and US policy in the 1980s

With the Reagan Administration (1981-9) committed to reducing the scope of public institutions in the economy both in the US and abroad, the US Government became distinctly cool toward large and powerful multilateral agencies. A US Treasury Report published in 1982 developed some recommendations which would make continued US participation in the multilateral development banks (MDBs) contingent upon certain policy changes. For the IDB, the report recommended that borrowing countries be 'graduated', i.e., made ineligible for further loans, once their economies reached a certain level of development (measured by GNP per capita). This was pointed particularly at the 'big four' Latin countries, which the US thought should be relying predominantly on private sources of capital. Other recommendations for the IDB's lending programme included a greater emphasis on private sector development, promotion of trade liberalisation, and requirements of domestic economic policy reforms. The report also singled out the need to improve the IDB's weak auditing and evaluation procedures.

It was not until negotiations began in 1986 on the seventh replenishment of the IDB's capital that these issues became a subject of serious discussion. The US position at the outset of negotiations included four main demands: first, the design of economic strategies by borrowers to guide IDB lending; second, implementation of appropriate policy conditions to support 'adjustment'-type loans; third, restructuring the IDB to enable it to undertake the necessary policy analysis and programme design; and fourth, a veto for the US, as the member 'providing the bulk of the IDB's usable resources', on the Executive Board.

The borrowing members, the 'big four' Latin American

1. See ODI Briefing Paper *The European Bank for Reconstruction and Development,* September 1990.
2. See ODI Briefing Paper *Recent Initiatives on Developing Country Debt,* April 1990

countries in particular, strongly opposed the US demands. Negotiations to provide the Bank with much-needed additional capital were therefore stalled for three years. Other, smaller, developing countries were damaged by the conflict between the US and the big four.

Argentina, Brazil, Mexico and Venezuela, the hemisphere's biggest debtors, had always looked to the IDB to provide them with a net inflow of finance (new loans greater than the principal and interest payments on old loans). After 1982, they needed this more than ever to ease their debt-servicing and balance-of-payments problems. Nor did they want the imposition of conditionality or demands for policy reform similar to those coming from the World Bank and IMF. The smaller borrowing members were more willing to compromise, possibly because many were more urgently in need of finance.

The impasse severely restricted the IDB's lending and its broader policy role. Its lending to the major debtors was much lower than that by the World Bank in volume (Table 3) and relative to its total lending. In the last five years Mexico has received 35% of the World Bank's lending to Latin America, but only 10% of IDB loans; Brazil 24%, compared to 14%; and Argentina 11% (7%). These three debtors thus accounted for only 30% of IDB lending, but 70% of the World Bank's to Latin America. In the last year for which data are available, the World Bank proportion was reduced to just over 50%, while the IDB remained at 30%.

The US did eventually temper its policies toward the multilateral banks. The size of the debt problem and its resilience to short-term solutions between 1982 and 1985 led, first, to the Baker plan of 1985, then to the Brady plan of 1989. Both recognised the need to restore investment and growth in the debtor countries. To this end, they advocated an active role for the multilateral banks, particularly the World Bank and the IDB.

The Baker plan called for some US$40bn in additional loan disbursements during 1986-88, half from official sources (principally the World Bank and the IDB) and half from the commercial banks. But the IDB did not have the capital to respond.

The inadequacy of the Baker plan became increasingly evident between 1986 and 1988, so it was succeeded (under the new US administration) by the Brady plan. This gave more encouragement to commercial banks to alter the terms of debt, and a supporting role for official institutions. It was launched by Treasury Secretary Brady shortly before the 1989 annual meeting of the IDB in Amsterdam.

There, under 'the Amsterdam compromise', the US softened its position on key issues, while the big four Latin members accepted a need to strengthen the IDB's capability in policy-based lending. They also conceded more power to the US to delay decisions, although not a veto. As a result, the capital replenishment of $26.4bn was agreed. This permitted an immediate recovery in lending to $2.6bn in 1989, and $3.8bn, a new peak, in 1990 (Table 2).

Table 3
IDB and World Bank lending to major borrowers (commitments) (US$m)

	1989	1985-9
IDB		
Argentina	11	941
Bolivia	170	521
Brazil	525	1,726
Chile	640	1,659
Colombia	40	1,287
Costa Rica	201	561
Dominican Republic	171	461
Ecuador	58	869
Mexico	143	1,241
Uruguay	26	274
Venezuela	120	633
Total	2,618	12,759
World Bank[a]		
Argentina	0	3,022
Brazil	1,569	6,517
Mexico	2,608	9,450
Total	5,965	26,994

Source: World Bank and IDB Annual Reports

a. IBRD and IDA, fiscal years, 1986-90.

Policy issues within the IDB in the 1990s

The funding level of the Inter-American Bank has been set, at least until the end of 1993. Two points at issue between the US and the Latin Americans in the IDB are not fully resolved. Reduced to their essentials, they are, first, the nature of the bank's conditions on loans to borrowing countries, and, second, the desire for increased political control of the IDB by the US and other developed-country members.

Conditionality

Strong disagreement arose over the proposal, backed by the US, to initiate 'structural adjustment'-type loans carrying macro-economic policy conditions similar to those of the International Monetary Fund and the World Bank. The controversy over the IDB embarking on sectoral loans stemmed from the opposition of many member countries to the conditions imposed by the IMF and World Bank in their 'policy-based' or 'adjustment' loans which have sometimes been associated with harsh austerity measures. Traditionally, the IDB's loans have been for particular projects.

The compromise is that the IDB adjustment loans will be designed on a sectoral basis. Conditionality will not apply to project lending. Sectoral loans will be limited to 25% of the IDB's total lending during 1990-3, and conditions will only involve changes in recipients' economic policies in the sector concerned. The sector problems likely to be addressed by such lending include the operating efficiency of currently installed capacity, the balance between revenues and expenditures, and the way goods or services are priced in the sector. A prime objective of sector loans will probably be to reduce the cost of the sector to the government's budget. Accordingly, typical conditions in a sector loan might include the termination of subsidies to state-owned enterprises in the sector, or prevention of automatic absorption of deficits by the government. Such conditions could result in plant closures, with job losses, or higher prices.

The Amsterdam compromise requires the IDB to tie its sector loan conditions to those of the World Bank. The rationale of this linkage is to ensure consistency in the policy reforms to be fostered. However, there was dissatisfaction with this formula among the Latin American countries. Therefore, as part of the compromise, the IDB will review its experience after the first two years (in 1991). During this period, the IDB will train staff in sectoral lending in order to permit it to identify, prepare and administer subsequent loans independently. In 1990, sectoral lending was $1.3bn, more than a third of the total. (The IDB was not the only regional bank to find itself under pressure to move towards more programme-based lending, or to find a compromise. The Asian Development Bank reached agreement on a 15% limit.)

Political control

The US director holds 34.6% of the votes on the Executive Board. Consequently, it has veto power over loans financed from the Bank's soft window, the Fund for Special Operations, for which the Bank's charter requires a two-thirds majority. This provides concessional loans to the poorest countries. The US does not enjoy the same power, however, for loans through the Bank's hard window, for which the charter requires only a simple majority. The US has long sought the right to veto these loans as well on the grounds that it provides the IDB with 70 percent of its 'usable' resources. This claim is based on an assumption that only the developed member countries make their contributions in hard currency whereas the developing countries provide their own, inconvertible currencies; the US accounts for 70% of developed country contributions. In fact, the borrowing members provide a significant portion of their paid-in subscriptions in convertible currency.

The US began the seventh replenishment negotiations by demanding a veto over all loans. This was rejected by the Latin American members. The compromise which emerged in Amsterdam allows any one director to delay a loan for two months, and two directors to delay a loan for up to a year, which could effectively terminate it.

In the 1980s, two considerations had increased US pressure for a controlling role. It had been anxious since its 1982 Treasury Report to remedy the many operational inefficiencies of the bank, a desire widely shared by other member countries. In response, the IDB's new president, Mr Iglesias, reorganised the internal structure of the bank. A programme of voluntary early retirement permitted the IDB to reassign existing staff and recruit new people.

The second reason was the US interest in a voice on the nature of conditions on the Bank's new lending programme in order to ensure the adoption of the kinds of policy changes which it felt necessary. The tie to the World Bank was designed to provide an indirect control, at least in the short run.

New challenges for the IDB in the 1990s

A greater role in debt settlement, new funds from Japan, concern for the environment, and a growing involvement in trade issues could influence the evolution of the IDB. The US has now identified the IDB, with the IMF and World Bank, as one of the institutions with which countries must reach agreement to be eligible for the *debt reduction facility* which is part of its new 'Enterprise for the Americas'. This is tied to the Bank's new role in imposing policy conditions, as well as the proposed $1.5bn fund to support investment.

Japan has also established a trust fund for the IDB to administer, and the Bank has started to engage in parallel financing with the Japanese Export-Import Bank. Japan still has only a 1% voting share in the Bank (this is larger than any European country, see table 1), but it has a growing interest in developing a role in regions other than Asia.[3]

The IDB remains, however, heavily dependent on the US. Although Spain has also taken an active interest, Canada is the only industrial country other than the USA with a more than 1% share of the votes and capital (and with its own Executive Director). The UK's share is just under 1% and its contribution in 1989 was £1.28m, supplemented by a £1m grant to the IDB Fund for Special Operations. In contrast, the UK contributed £5.3m to the African Development Fund and nearly £20m to the Asian Development Fund.

The environment is likely to bring about a growing debate. The IDB has financed several loans in the power sector whose environmental impact has been criticised. The Latin American countries resisted calls from developed members to establish an environmental division and for the articulation of an IDB environment policy. '*Environmental conditionality*' is seen by many developing countries as an unwarranted intrusion on their sovereignty, both in principle and on the grounds that most of the world's environmental problems have been caused by the developed countries. Nonetheless, the Bank has now established an environmental division and supported technical assistance for environmental impact studies. A section on 'environmental implications' must now be included in all project proposals. However, this may not satisfy concerns in industrial countries over the rain forest and other ecological issues. The Bush initiative includes a debt-environment link, and a debt-for-nature swap was arranged by Mexico in March 1991.

One manifestation of the new policy activity and regional cooperation among Latin American and North American governments has been a revival of interest in *regional trade agreements*. After expanding in the 1970s, regional trade in Latin America fell by even more than the area's total trade in the early 1980s as incomes fell and essential capital imports from industrial countries had to be maintained. Since then, the US and Canada have formed a free trade area. The Central American countries have revived the Central American Common Market, with the objective of free trade by 1992. The Caribbean countries (CARICOM) have set a target date of 1991. Brazil and Argentina are negotiating to eliminate trade barriers, originally with a target of 1999, now brought forward to 1994. The Andean Pact (Bolivia, Colombia, Ecuador, Peru, and Venezuela), whose significance shrank in the 1980s, is reviving. These traditional sub-regions are starting to form links. The most publicised is Mexico's opening discussions with the US (and Canada), but other Latin American and Caribbean links are forming, within the region and between other countries and the US. The largest is ALADI (ten of the South American countries and Mexico), which is reducing tariffs among members.

The most ambitious initiative is the Bush proposal of June 1990 for *free trade throughout the hemisphere*, the most conspicuous, although not the most immediately relevant, part of 'Enterprise for the Americas'. Although it was clearly stated to be a 'long-term objective', it has been enthusiastically taken up by the IDB.

The IDB starts the 1990s in a much stronger position than it had in the early 1980s. If the optimistic forecasts are right, its member countries will be among the successes of the 1990s. The Bank has new management and increased funding for its project lending. It succeeded in avoiding major concessions to the pressures for greater political control. It has potential new roles in the sectoral and trade policies of its members, and in regional integration.

3. See ODI Briefing Paper, *Japanese Aid*, March 1990.

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