

Opportunities for Future IDB Involvement in Latin America and the Caribbean

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The Inter-American Development Bank (IDB) is the premier development bank in Latin America and the Caribbean (LAC), providing on average [\\$9.7 billion](#) per year since 2008 in the form of disbursed loans and an average of [\\$534 million](#) per year in approved grants. Since its founding in 1959, the IDB has worked to find innovative and effective approaches to address the economic, social, institutional, and environmental challenges in the region. For example, the IDB's efforts to improve educational outcomes benefitted more than [2 million](#) students in 2016. The IDB has a unique role in the region that no other agency can match, and it enjoys a high level of trust and cooperation among many LAC countries.

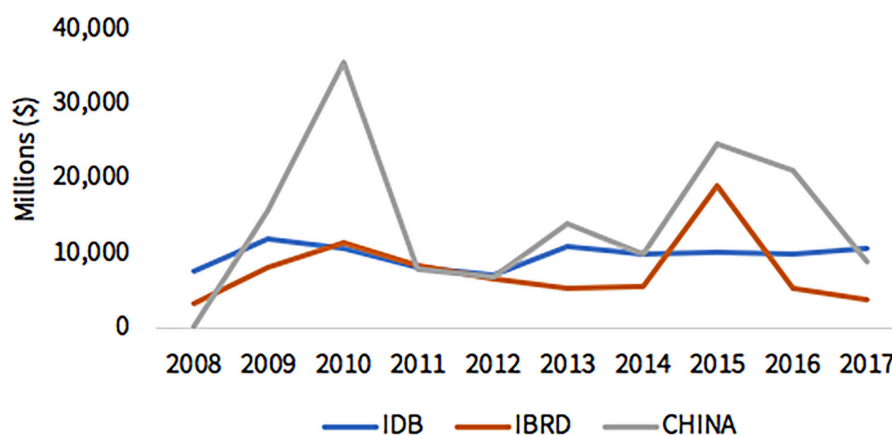
Under IDB president, Luis Alberto Moreno, the IDB has been able to lead more programming in the region and expand its financing under the [Ninth General Capital increase in 2010](#). President Moreno's three-term presidency ends in 2020. His achievements should be followed by a leadership that can uphold the same standards. However, the region will evolve over the next decade, and it will require that the IDB respond to new and unforeseen challenges, which the next president will need to tackle. This paper is intended to put forth ideas on where the IDB should focus over the next 10 years by identifying strategic priorities important to the development of LAC.

Accomplishing these strategic priorities will require strong leadership. If the IDB wishes to expand its impact over the next 10 years, the organization must recognize its limited resources and comparatively low capital flow into the region, while capitalizing on its track record of success. In 2017, LAC's inflow of foreign direct investment (FDI) rose by 8 percent in 2017, but its figures are still the [second lowest](#) region globally.

Compared with the World Bank's International Bank for Reconstruction and Development (IBRD) and Chinese development financing in the region, the IDB's operations (based on loan disbursements) have remained relatively stagnant (Figure 1). The limited resources of the IDB compared to other development

finance in the region will require that it prioritize certain efforts over others and that it directs its resources to partner with the private sector to maximize its impact. Moreover, it should focus its financial efforts towards low-income countries that cannot tap global financial markets for financing and offer middle- and high-income countries technical expertise, policy advice, and broker partnerships with leading scientific institutions for these countries. The IDB will need to adapt its assistance model to countries' different needs.

Figure 1: Development Finance in Latin America and the Caribbean



Sources: [IDB Financial Statement 2018](#); [China-Latin America Finance Database](#); [World Bank Annual Reports and Financial Statements \(2008-2018\)](#). Note: IDB and IBRD figures are based on loan disbursements in the region.

The region has undergone many changes in the last decade. For example, between 2006 and 2016, the middle class in LAC grew nearly [50 percent](#). Yet many countries in the region face the risk of the [middle-income trap](#), that is, the inability of a country to surpass certain income levels, making it difficult to transition to high-income levels and increase growth. If nations seek to overcome the middle-income trap, they must first prioritize policy actions to improve the rule of law, the taxation system, access and quality of education, and access to finance and economic diversification.

The organization will need to step up to existing and forthcoming challenges that include an increased range of development actors, demographic changes, security, increased unemployment, changing migration flows, conflict and instability, poverty and inequality, corruption, a rising middle class, and environmental vulnerabilities.

Contributions of the IDB in a Changing Context

The future challenges the region faces have given the IDB the opportunity to leverage its strengths and increase its effectiveness, particularly through facilitating knowledge-sharing and technical capacity among LAC countries. The IDB has a unique advantage over other donors in the region because it has a good reputation with national governments and is a trusted partner for many local stakeholders.

It would be worth rethinking the division of labor at the country level between multiple international actors including the IDB, the World Bank, bilateral development finance institutions and regional players to clarify their purpose based on their strategies. Given its local knowledge and experience in the region, its ability to bring in the private sector, and its vast funding pool, the IDB should focus more on leveraging its financing to attract more capital, or crowd in private capital in sectors such as [infrastructure](#), which is a significant bottleneck to growth in LAC. The IDB is already a large player in infrastructure investments

with more than [\\$2 billion](#) invested in transport, urban development and housing alone in 2017, compared with the [Development Bank of Latin America \(CAF\)](#) which spent [\\$24 million](#) in infrastructure in 2017. Other multilateral development banks like the World Bank, for example, should [reduce their lending role](#) and focus on building technical capacity through policy and regulatory reform.

In addition, the IDB should place greater emphasis in coordinating with the World Bank and other regional players, such as the [CAF](#) and [Central American Bank for Economic Integration](#), addressing the comparative advantages of each and exchanging best practices and lessons learned from diverse experiences. This collaboration should focus on sharing initiatives to limit programming overlap and reduce gaps in funding and programmatic assistance. The goal of these partnerships across development actors should be to bring investments into the region; promote social and economic growth; and support governments as they create, adopt, and implement new frameworks to encourage growth.

The IDB will need to decide what kind of relationship it wants with emerging players in Latin America that were not present 10 years ago such as Chinese development banks, impact investors, and private equity groups. Such new players should also be held to international standards and best practices, including the Paris Club and Equator Principles.

What Are the Strategic Priorities of the IDB over the Next 10 years?

Given that there are limited resources, the IDB should focus its funds and technical skills on a few key areas:

1. Private sector inclusive growth
2. Quality infrastructure
3. Governance and the fight against corruption
4. Regional security and stability
5. Productivity and innovation

1. PRIVATE SECTOR INCLUSIVE GROWTH

Many countries will have to attract private investment to spur economic growth across LAC countries, which will require a strong enabling environment and mitigating country vulnerabilities. Investors rely on Moody's and Standard & Poor's rankings. Currently, there are only [10 countries](#) in the LAC that meet investment grade criteria. According to AT Kearney's index on attracting FDI, in 2018 only [2 of the top 25](#) ranked countries were in LAC. One of the largest perceived risks that investors considered in 2018 was political instability in emerging markets because of the interconnection between political risk and economic growth. The IDB has a role to play in removing obstacles for investors and promoting private sector growth.

In 2016, the IDB [consolidated](#) all private sector operations under an arm of the IDB formerly known as the Inter-American Investment Corporation, now rebranded as "IDB Invest." The Multilateral Investment Fund ([MIF](#)) continues as an independent trust fund of the IDB. However, the MIF's future is uncertain. The 2016 MIF replenishment, in which the United States did not participate, was slated to be the final five-year tranche. IDB Invest seeks to promote development through the private sector, increasing competitiveness and helping companies grow in LAC. Additionally, the IDB will need to focus inwardly on countries' existing businesses, particularly small and medium-sized enterprises (SMEs), to promote their growth and create opportunities for employment. [90 percent](#) of companies in Latin America are SMEs, and they employ half of all workers. To bolster growth in the region, the input of the business community will be integral to [increase productivity](#), create jobs, foster economic development, and strengthen local value chains.

2. QUALITY INFRASTRUCTURE

The IDB should also target strategic sectors in each country that could benefit regional growth. One such strategic sector is infrastructure, which is currently funded primarily by the public sector ([70 percent](#)). In a 2016 report by McKinsey Global Institute, Latin America had the [lowest expenditures](#) on infrastructure globally as a percentage of world GDP between 1992 – 2013. The global average is 3.5 percent of GDP, and during that time period, Latin America spent (on average) [2.4 percent](#) of world GDP on infrastructure. Estimates vary greatly, but some claim that Latin America will have to spend up to [\\$200-\\$300 billion](#) annually, or 6 to 8 percent of GDP annually, from 2013 to 2020 to fill the infrastructure gap.

Low-quality infrastructure can dampen opportunities for the growth of businesses and trade. For example, access to transportation and [transportation costs](#) have long been some of the most pressing issues for LAC exporters. Alongside traditional trade barriers such as tariffs and quotas, poor physical infrastructure results in high transport costs between countries and threatens the region's trade competitiveness. [High transport costs](#) put LAC exporters at a distinct disadvantage compared to firms in other regions.

There is widespread recognition that building quality infrastructure is a high priority, but regional projects in infrastructure are complex and challenging processes. A top priority for enabling those projects is facilitating healthy partnerships that will benefit all parties involved.

3. GOOD GOVERNANCE AND ANTI-CORRUPTION

The hard issues that will need to be resolved in LAC include corruption and poor governance, which have persistently been a problem in the existing political climates of many countries. Almost [60 percent](#) of Latin Americans stated in 2015 that they were not at all satisfied ([19 percent](#)) or not very satisfied ([37.5 percent](#)) with the functioning of democracy, with only [10 percent](#) stating they were very satisfied. Only [36 percent](#) of Latin Americans trust election outcomes.

A [2016 poll](#) by Latinobarometro shows that citizens of Brazil, Bolivia, Chile, and Peru cite corruption as one of the most significant problems in their countries. It is listed as an intermediate problem in seven other countries. Regionally, [43 percent](#) of respondents noted that it is not possible to eradicate corruption. Building capacity within institutions and strengthening public governance in the region is vital to increasing the effectiveness of policy, fighting corruption, and rebuilding trust. Additionally, it serves to increase the resilience of countries and prevent them from backsliding in their progress if geopolitical challenges or natural disasters test them.

4. SECURITY AND STABILITY

Security is a critical challenge in the region. According to [a study](#) by Igarapé Institute, a think tank, LAC is the most violent region in the world. Recent polls place crime as a key concern for citizens. A recent estimate by the IDB revealed that crime costs LAC countries on average 3 percent of GDP per year (nearly [\\$236 billion](#)). Moreover, the [Gallup Law and Order Index of 2017](#) lists LAC as the lowest ranked region.

Law enforcement and judicial institutions remain very weak in many LAC countries. Without this basic infrastructure, other sectors cannot move forward. The IDB should focus on strengthening institutional capacity in these countries; economic growth and national development rely on the ability of the government to uphold the rule of law and create an environment that attracts investment.

The IDB has led a few studies on crime and violence in the region and has an active initiative on [citizen security](#) to help find local solutions to crime and promote justice in the region. The IDB has become a trusted broker for security, but there remain pockets of fragility and conflict that can threaten the stability

of the region. Without attention to the source of insecurity, other countries face spillover effects with regard to drug trafficking, increased migration, and increased crime and violence.

Countries that have high levels of inequality and social exclusion are more susceptible to greater political instability, thereby leading to larger challenges. Among the 33 countries in the LAC region, only 10 fall into the stable category of the [2018 Fragile States Index](#). Latin America still has pockets of poverty and countries with complex governance challenges, including those in the [Northern Triangle](#), Venezuela, and Cuba. The IDB could have a long-term role in these places to help relieve security challenges and renegotiate the social contract between governments and citizens by providing support to rebuild transparent, anti-corrupt government institutions.

5. PRODUCTIVITY AND INNOVATION

The IDB has identified low productivity and innovation as a key challenge to development in the region. Innovation is [defined](#) as the process of turning an idea or invention into a commodity or service to be bought and sold. The policies that will need to be enacted to jumpstart innovation and productivity differ by country, but often include creating an enabling business environment and developing [inclusive](#) social, geographical, and sectoral policies.

A lack of innovation in the region can be explained in part by low levels of private sector involvement, and it can prolong the aforementioned middle-income trap, limit growth in the region, and stunt productivity. The 2018 [Global Innovation Index \(GII\)](#) ranks the innovation performance of LAC behind Southeast and East Asia and Northern and Western Africa. According to other indicators that measure innovation, such as research and development (R&D) spending, the region underperforms. LAC spent [0.7 percent of GDP](#) on R&D in 2013, which is less than North America and Western Europe (2.4 percent), East Asia and the Pacific (2 percent), and Central and Eastern Europe (1 percent).

One of the major sectors that has been challenged by decreased productivity is agriculture. LAC contributes [11 percent](#) of the value of global food production and represents [24 percent](#) of the world's arable land. However, agriculture in the region has suffered from slow growth in productivity—[1.9 percent](#) annual growth rate between 1961 and 2007, compared with [2.4 percent](#) in OECD countries. Part of this lag in productivity can be explained by insecurity, poor institutional and regulatory frameworks, and inequality, which can directly impact the development of quality human capital. In fact, according to a recent World Bank [report](#), the top policy priority to improve Central America's productivity was improving the regulatory environment. Given its importance to global food supplies and to supporting trade in the region, improving the regulatory environment should be an underlying focus in IDB projects.

Conclusion

The strategic priorities of the IDB for the next 10 years should be centered on private sector inclusive growth, quality infrastructure, governance and the fight against corruption, regional security and stability, and productivity and innovation. This is a large undertaking. The future leadership of the IDB should be adaptive given the inherent changes in the region, but firm about the reforms that are still lagging in some countries. The IDB has the responsibility to manage its partnerships, increase its effectiveness and efficiency, and make positive change for the region's development. It will require expanding the role of the private sector, leveraging resources to mobilize capital that will contribute to the aforementioned strategic priorities.

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