

THE MULTILATERAL DEVELOPMENT BANKS IN LATIN AMERICA AND THE CARIBBEAN REGION

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I. INTRODUCTION

You are not here merely to make a living. You are here in order to enable the world to live more amply, with greater vision, with a finer spirit of hope and achievement. You are here to enrich the world, and you impoverish yourself if you forget that errand. — Woodrow Wilson

In March of 2002, the President of the World Bank, Jim Wolfensohn, made a presentation to the Woodrow Wilson Center on the future of the World Bank development agenda after the events of September 11th. Mr.

Wolfensohn asked the staff of the World Bank to share his vision of the future of the World Bank. On that occasion, he stressed:

After September 11th, poverty is our greatest long-term challenge. Grueling, mind-numbing poverty which snatches hope and opportunity away from young hearts and dreams just when they should take flight and soar.

Can we win a war against poverty? And if we can't be sure, should we wager our resources? Can we afford to lose the war against poverty? How much are we prepared to commit to preserve our children's future? What is the price we are willing to pay to make progress in our lifetime toward a better world? And to the doubters I would say: Look at the facts. For the facts show that despite difficulties and setbacks, we have made important progress in the past, and we will make progress in the future.

However, in order to understand the role of the World Bank in the struggle against poverty, it is imperative to clearly define the power relations among the industry's major forces: the buyers, competitors, suppliers, and potential substitutes.

Thus, the objective of this paper is to apply Michael Porter's Five Force Model¹ to the Regional Department for Latin America and the Caribbean Region of the World Bank. By doing so, we can respond to the questions above and develop a framework that could be used as part of a broader strategy for other multilateral development banks ("MDBs"), and in particular the World Bank. We will focus our attention on the normal lending activities of the World Bank in the region and its private sector lending activities through the International Financial Corporation ("IFC").

1. *See generally* MICHAEL E. PORTER, *COMPETITIVE STRATEGY* (1980) (The present discussion takes as the major output of the multilateral development banks ("MDBs") the amount of lending provided to the Region. Due to the nature of MDBs, profitability is not be a good way to measure the success or failure of a MDB. Currently there is a discussion under way to develop an "output" oriented approach. However, there is no agreement yet on how to effectively measure the effectiveness of MDBs' outputs.).

II. FIVE FORCES ANALYSIS

A. *The Role of MDBs in the Industry?*

Thus is said that one who knows the enemy and knows himself will not be endangered in a hundred engagements. One who knows neither the enemy nor himself will be invariably be defeated in every engagement. –Sun Tzu, The Art of War, Planning and Offensive

One of the problems facing international financial institutions is how to clearly identify the industry in which they are acting. In many instances their mission is confused with the area in which they are acting. For example, it has been said that the World Bank is in the “poverty alleviation” business. However, by definition, there is no such thing as a business to alleviate poverty.

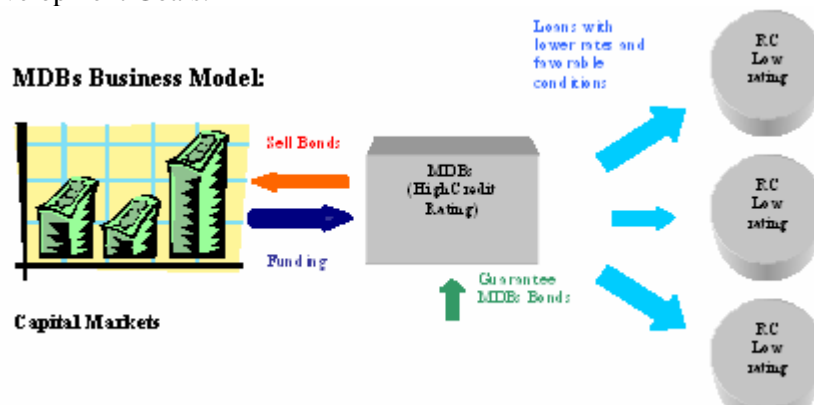
In order to identify the industry in which MDBs are acting, we have to look at the product MDBs are providing to their clients and their core competencies. The core competency of MDBs is to lend money to governments in developing countries and economies in transition. These funds, in turn, can be used to cover shortfalls in budgets or to allow governments to continue program development without having to increase their debts by borrowing from the international capital markets. As a result of providing this financial assistance, MDBs introduce their own policy agendas into the governments to which they lend money. Therefore, we can conclude that MDBs are competing in the global capital markets.

Thus, it can be said that MDBs compete with investment banks for their clients and not with other official development institutions, such as United States Agency for International Development (“USAID”) or Deutsche Gesellschaft für Technische Zusammenarbeit (“GTZ”), or private foundations such as the Rockefeller Foundation. This makes sense if we look at the reason why MDBs were actually created. The initial idea to create MDBs was simple and perfectly adapted to the opportunities and constraints of the capital markets in the postwar era. With capital flows restricted, as well as financially risky, many governments were unable to attract foreign private capital to finance public sector activities.

The business model of MDBs was to create an institution backed by the capital commitment of capital rich countries, such as the United States, which could borrow at the lowest market rates and lend economically to countries with need. First in line were nations destroyed by the war and those in the early stages of economic development. Today, however, the

scope has expanded to those countries that are simply in need of international financial support and cannot access international financial markets to borrow money on reasonable financial terms on their own.

In return for this more favorable rate, the borrowing country agrees to undertake a set of actions called conditionalities, which are designed to reform the borrowing country's economic sectors in accordance with a set of policy measures identified by MDBs' own political agenda.² The World Bank defines its agenda based on the need to achieve its Millennium Development Goals.³



B. Who are the competitors in this market?

1. Inter-American Development Bank

The Inter-American Development Bank (“IDB”), the oldest and largest regional multilateral development institution, was established in December of 1959. The IDB was created in response to the limitations of the World Bank and the IMF, also known as Bretton Woods institutions, which were increasingly focusing away from Latin America and the Caribbean Region towards other parts of the world. The goal of the IDB is to help accelerate economic and social development in Latin America and the Caribbean.

In carrying out its mission, the IDB has mobilized financing for projects that represent a total investment of two hundred and sixty-three

2. See Harold James, *International Monetary Cooperation Since Bretton Woods* 619 (Oxford University Press, 1996).

3. THE UNITED NATIONS, UNITED NATIONS MILLENNIUM DECLARATION (2000), available at <http://www.developmentgoals.org> (For example, the United Nations set as a goal to reduce extreme poverty by ½ by the year 2015).

billion U.S. dollars. Annual lending has grown dramatically from two hundred and ninety-four million dollars in approved loans in 1961 to almost five point three billion in 2000. Loans peaked in 1998 at just over ten billion dollars.

The IDB is considered extremely “Latin” and close to its client governments. Its President, Enrique Iglesias, is a well - known former Uruguayan Foreign Minister. His influence has given the IDB a definite Latin American flavor.⁴ Nevertheless, despite these attempts to be as close as possible to their clients, the IDB’s disbursement ratio of approved loan commitments is extremely low compared to the World Bank and the Andean Development Corporation (“CAF”).

2. Andean Development Bank

The Andean Development Corporation provides development financing to promote sustainable development and trade integration in the Andean Region (Bolivia, Colombia, Ecuador, Peru, and Venezuela). It is currently the leading source of multilateral finance in the Andean region. Its capital ownership is structured so that the five Andean shareholder countries contribute ninety-five percent of the paid in capital and ninety-nine percent of the callable capital.⁵ To date, these shareholders have borrowed twenty-five billion dollars on terms they would not have enjoyed if their countries had remained outside the collective.

Unlike the World Bank and the IDB, the amount paid into callable capital by the CAF is high, nearly fifty percent (compared to five percent for the World Bank). In 1993, the CAF received an “A” investment grade rating from Standard and Poors as well as Moody’s and Fitch. This rating is now higher than any other sovereign in Latin America. The CAF’s success in a region, characterized by high volatility, economic crisis, and political instability has much to do with its unique structure. Shareholders have a clear self-interest in maintaining and increasing CAF’s institutional credibility and have opted to keep their obligations to CAF in full despite numerous crises.

4. Spanish is the working language in the IDB, and many of its senior advisors are former Ministers of Finance from the region. The modus operandi of the institution is similar to other institutions in Latin America.

5. See BLACK’S LAW DICTIONARY 198 (7th ed. 1999) (“security redeemable by the issuing corporation before maturity”).

3. Caribbean Development Bank

The Caribbean Development Bank (“CDB”) was established on October 18, 1969, in Kingston, Jamaica. Its purpose was to contribute to harmonious economic growth and development of member countries in the Caribbean. In addition, CDB has promoted economic cooperation and integration among its member countries—with special regard to the needs of the less developed members of the Caribbean. Major donors to the CDB include Canada, the United Kingdom, the United States, Germany, and the IDB. Since its establishment, the CDB has provided nearly two billion dollars in loans and credits to Caribbean countries.

4. The World Bank

The World Bank Group (“the Bank”) is one of the world's largest sources of development assistance. The Bank, which provided over seventeen billion dollars in loans to its client countries in fiscal year 2001, is now actively working in more than one hundred developing economies. It brings a mix of financial aid and ideas to improve living standards and eliminate the worst forms of poverty. For each of its clients, the Bank works with government agencies, nongovernmental organizations, and the private sector to formulate assistance strategies. Worldwide offices institute the Bank's programs, act as liaisons with government and civil society, and work to increase understanding of development issues. The World Bank provides between four and six billion dollars in loans and credits to the Latin America and Caribbean regions. See Chart 1 for a comparative analysis of lending commitments of all MDBs to the region.

The World Bank has been accused of lacking a clear understanding of what is happening in the Latin American and Caribbean regions. For example, until 1999, the Vice Presidents responsible for Latin America were Pakistanis who did not speak Spanish. However, new Vice President David de Ferranti, a U.S. citizen, has made a clear commitment to change the image of the World Bank in the Region. Based on the latest client surveys, he has been successful.⁶

5. Private Investors

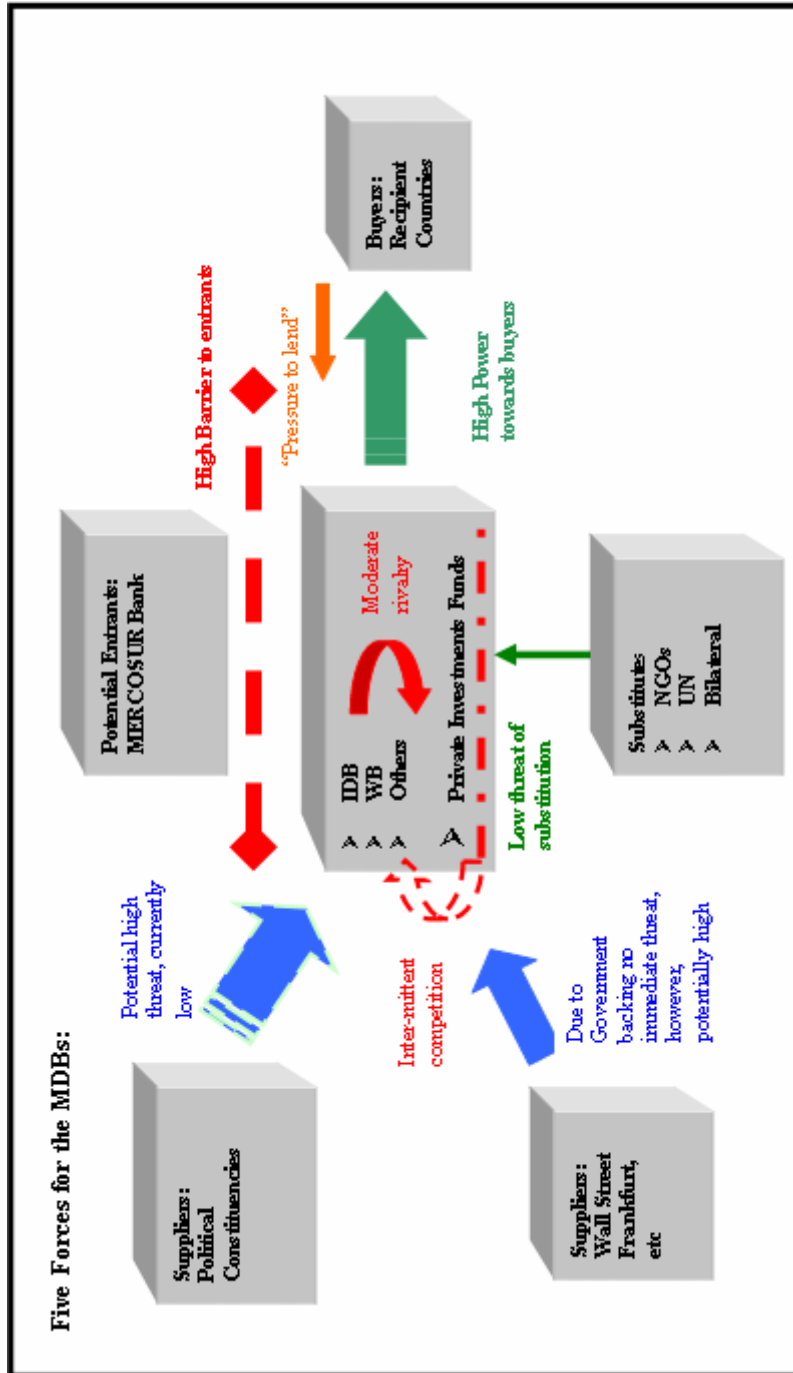
When interest rates in industrialized (“OECD countries”) are low, capital is abundant and opportunities to earn a good return are scarce.

6. Recent Client Survey indicate that the image has changed favorably in 5 of 7 categories, such as closeness to the client, responsiveness to its needs, etc.

Private investors start looking at emerging markets as a potential source of income. In the 1990s, emerging market funds became an investment option for many institutional and private investors in OECD countries.

High rates of return made this industry extremely attractive. Many investors, such as MDBs, who traditionally imposed tougher non-financial conditions on the borrowers, saw themselves competing with emerging market funds that provided money to governments in developing countries without proper safeguards. The immediate impact on MDBs was a reduction in lending volume to their clients. In many cases, clients preferred to borrow money at a higher rate without the strings that are attached to the loans of institutions such as the World Bank or the IDB.

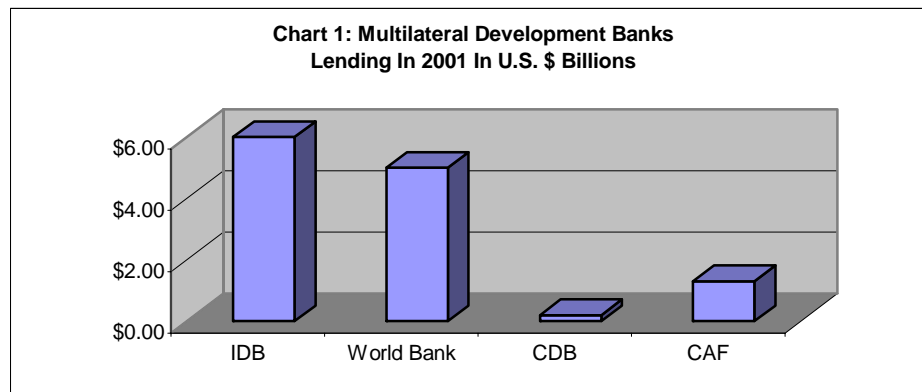
Currently, the situation has changed significantly. The Asian, Russian, Brazilian and Argentinean financial crises have increased the risk of such investments, and have therefore reduced the attractiveness of such funds. Thus, investors have avoided putting money into emerging markets. This leaves only extremely selective investments in low risk countries such as Mexico. The situation may change again if economic conditions in industrialized countries improve along with confidence in some emerging economies. Should this occur, MDBs might be crowded out because private investors can become very selective. This leaves MDBs only the high-risk, low return, and small volume candidates.



C. Competitive Analysis

MDBs, namely the IDB and the World Bank, provide approximately fourteen to seventeen billion U.S. dollars in loans and credits to the Latin American and Caribbean Regions. See Chart 1. Rivalry among these MDBs is moderate in the Latin America and Caribbean regions, particularly between the IDB and the World Bank.

Why? Both institutions offer similar lending and advisory instruments; both lend on similar terms and volume; and both cater to the same governments. As a result, they compete for business in a market that is limited by the capacity of the country to take on additional debt.



The World Bank enjoys a comparative advantage in the Latin American and Caribbean regions. Comparing the terms of the loans both institutions offer, the World Bank presents the borrower with better terms than the IDB (total spread equivalent over LIBOR: World Bank: 64 basis points, IDB: 114). Furthermore, the World Bank can provide global expertise, whereas the IDB's knowledge base is more regional.⁷

However, from the point of view of the borrower, the IDB is considered to be more lenient when it comes to negotiating the loan. Furthermore, its "Latin nature" makes it easier to deal with for Latin American and Caribbean countries. Clients also assert that the IDB has better customer service than the World Bank. However, in terms of disbursements, the IDB's willingness and time frame to disburse their commitments after

⁷ World Bank, Report of the Task Force on the World Bank Group and Middle-Income Countries: Middle Income Countries' Development Challenges and Bank Group Role 3-5 (2001), available at <http://siteresources.worldbank.org/COUNTRIES/resources/mictf.pdf> (discussing challenges to middle-income countries, including diversity, poverty, market access, and global public goods).

Board approval is significantly longer than the World Bank. Ultimately, it is hard to say which institution prevails because governments often try to play one institution against the other.

Some proposals are being floated to replace the World Bank with regional institutions such as the IDB.⁸ Although possible, I do not believe that the clients or the donors would be better served by eliminating competition, thus creating a virtual monopoly for the IDB in the region. The smaller players in the region, such as CAF and CDB, do not compete directly with the IDB or with the World Bank. Instead, they have carved out a niche market for themselves by concentrating their lending and advisory services on smaller activities limited to specific sub-regions.

D. Who are our buyers?

The main buyers, or clients, of MDBs are governments, and in particular their ministries of finance. From the period spanning the end of World War II until 1990, MDBs, particularly the World Bank, were the main source of capital for many governments. However, in the 1990's, the implementation of the so called "Washington Consensus" (free market reforms, deregulation of the economies, democratization, etc.) prompted private capital flows to many middle income countries ("MICs"), as well as to a few low income countries such as China and India.

III. THE ROLE OF MDBS AND PRIVATE FLOWS TO EMERGING MARKETS ECONOMIES

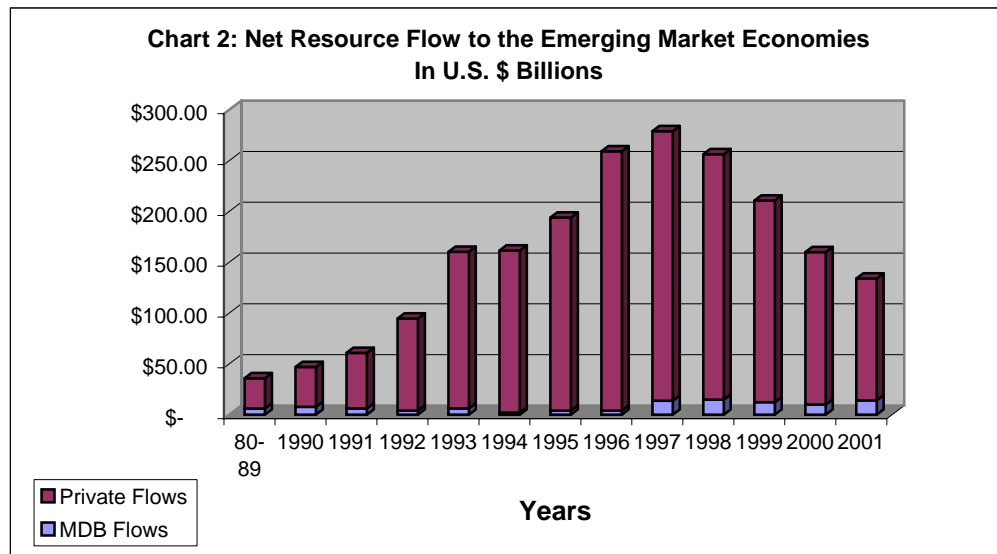
By the 1990s, private flows to the developing world suddenly outnumbered the flows from MDBs. This has raised the question of whether the original mission of MDBs still makes sense in these economies. See Chart 2. Until 1997, the reality on the ground seemed to support those who argued in favor of a retreat of MDBs from the global capital markets. This was based on the assumption that the buyers were becoming too powerful and were actually using the private capital flows as leverage against MDBs.

Argentina, Brazil, and Mexico consumed around seventy-five to eighty-five percent of the total capital flows to the region. Flows from the private sector to these countries in the 1980s were six times that of MDBs. The

⁸ See THE INTERNATIONAL FINANCIAL INSTITUTION ADVISORY COMMISSION, March 8, 2000 Report 68, available at <http://www.house.gov/jec/imf/meltzer.htm> ("To function more effectively, the development banks must be transformed from capital intensive lenders to . . . providers of regional and global public goods.")

ratio of private/public capital flows increased in the 1990s, peaking in 1994. Therefore, a crisis in one of these countries can have a significant impact, not only on the region, but also on the borrower.

In the Latin American and Caribbean Region, the success of the first wave of 1990's reforms seemed to indicate that graduation of some countries out of MDBs system was a reality. Demand for borrowing from the World Bank and other MDBs in 1999 and 2000, in terms of percent of GDP, was below 1980 levels. In many loan negotiations, the borrowers argued that they could get a better rate with the World Bank. Therefore, they tried to leverage the private investor to improve the terms of the loan.



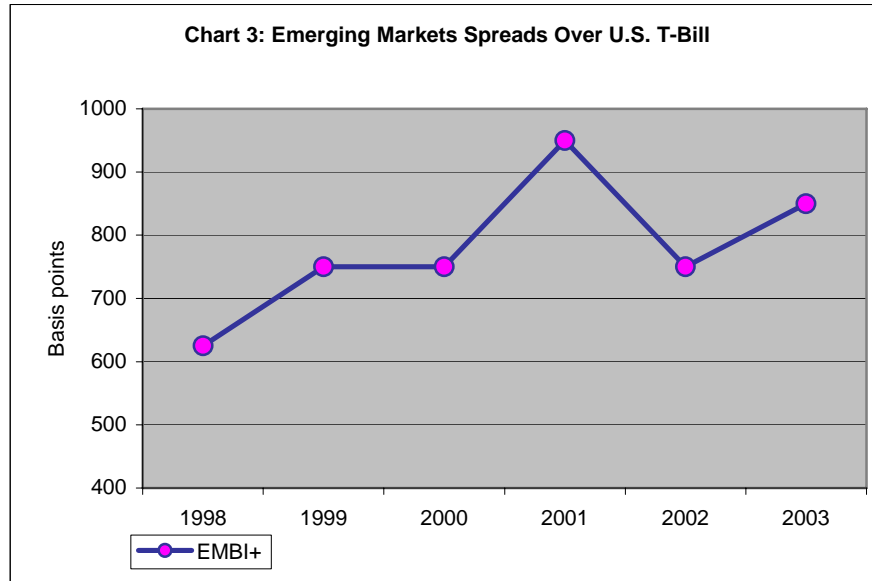
Source: Author's calculations based on World Bank data.

During this period, the buyers also started to pressure MDBs by demanding reduction or more flexibility in the conditionalities applied to the loans. However, the 1994 Mexican financial crisis changed the situation again. The international community felt that there was need for a concerted effort to respond to the requirements of the emerging economies and ensure a constant flow of resources to developing countries to avoid extreme downturns in their economic cycles. The amounts requested to cover these needs skyrocketed because of the exposure of emerging economies to private international debtors. International debt payments had increased in relative and absolute terms. Governments became much more dependent on funding from MDBs to compensate for shortfalls in their current account balance. In this context, emerging economies such as

Turkey, South Korea, Argentina, Brazil, and Mexico started to demand “emergency packages” to rescue their economies from cash flow problems. In requesting these packages, these countries argued that the downfall of one economy would have a devastating impact on the international financial markets. If their economies crashed, poverty would increase and much of the gains of the 1990s would be lost.

The prospects for the near future have dimmed even further in light of the weaker international economic and political environment. Growth rates for the Latin American region as a whole have gone down to 0.3% for 2002 and 0.6% for 2003. In 2004, the region is once again expected to reach growth rates of 3.5% or higher. Based on projections prepared by the World Bank, the Latin America and Caribbean Region, will require an additional net inflow of resources valued at seventy-five billion dollars in 2002 to cover new financial needs. For 2003 and beyond, we could assume that the demand for fresh money will increase at least at the projected GDP growth rate of 3.5%. These projections confirm that demand for international financing for the Latin America and Caribbean Region is expanding.

Despite this increased demand, it is highly unlikely that in the next three to five years private sector financing will play as significant a role in providing funding for emerging economies as it did in the past due to the growing political and economic risks in the region. See Chart 3. Under the best case scenario, the market will become much more selective by promoting investment in countries that bear the lowest risk for their investments.



Source: Bloomberg Financial Services database

The MDBs responded to these conditions and provided emergency assistance through what became to be known as “adjustment lending” operations. Huge, single, and quick, these disbursements of more than two to three billion U.S. dollars became the modus operandi for MDBs and replaced project oriented investment loans. Encouraged by this shift in demand, MDBs tried to increase their conditionalities, in exchange for lower interest rates, to respond to their constituencies in donor countries.

Over time, MDBs became more involved in issues that were outside their core competencies. MDBs thus became more alienated from their clients in developing countries, because the conditions imposed went against the political will of the borrower. In this context, during such times of crisis, MDBs should not be viewed as mere adjuncts to emergency stabilization lending programs such as the International Monetary Fund (“IMF”).

One way to allow MDBs to avert crisis would be to develop a new product line and provide pre-approved, counter-cyclical lending programs to help emerging economies anticipate, respond to, and ultimately avoid financial shocks.⁹ For example, a drawdown option makes sense

9. Jose A. Gurria & Paul Vockler, Carnegie Endowment for International Peace, *The Role of Multilateral Development Banks in Emerging Market Economies* 17, 22 (2001) available at <http://www.celp.org/econ> (referencing Mexico’s attempt in 1997–2000 to get future lending

particularly in countries that have good access to private markets because of reasonable policies and institutional environment. If this proposal materializes, it could reduce the competition of MDBs with private capital flows, but it could also increase the risks of MDBs.¹⁰

Another consideration concerns the exposure of MDBs' activities in other countries within the region. Due to the relative importance of funding, compared to their current account balances, smaller countries such as Peru, Colombia, and others in the Caribbean region are more inclined to accept conditionalities suggested by MDBs. The return on smaller investments, ranging from one hundred to one hundred and fifty million dollars per loan, looks more favorable to these countries in terms of quality and development effectiveness. Although these countries are small borrowers, demand is increasing and becoming progressively more important in terms of both quality and quantity.

IV. EXPOSURE AND NET INCOME CONSIDERATIONS

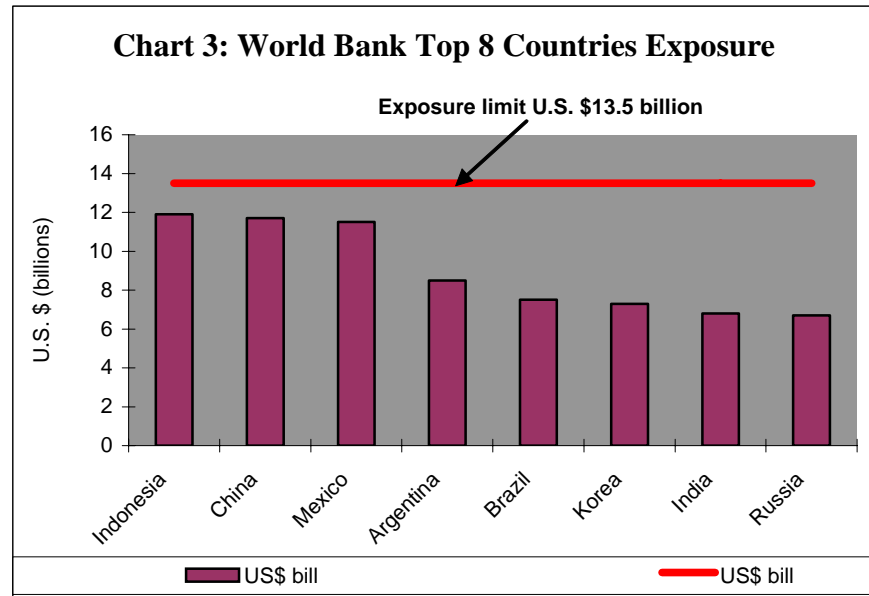
We have to also keep in mind an additional factor that could have a significant influence on the power relation between MDBs and the governments—that MDB's net income depends heavily on revenue generated from loans to middle income countries. For example, for the World Bank to be financially viable it needs to lend between ten and twenty billion U.S. dollars a year. Below that amount, the revenue stream is insufficient to pay off the commitments in the market. Above twenty billion dollars, it would be extremely difficult for the Bank to raise enough money without compromising its credit rating.

From 1997 to 2001, the World Bank's lending to Argentina, Brazil, and Mexico accounted for thirty percent of its total worldwide commitments. Therefore, a reduction in the demand from these countries will have a negative impact on the long-term financial sustainability of MDBs, including the World Bank. This makes lending to these countries imperative in order to ensure a constant flow of net revenue for MDBs. In other words, to stay alive financially, MDBs also need the big borrowers the same way smaller countries need MDBs to cover their financing. This situation, also known among the staff of MDBs as "pressure to lend," generates an important shift of power towards countries such as Mexico,

commitments against loss of confidence in the Presidential election as an example of a new MDB project).

¹⁰ See *id.* at 17–18.

Brazil, or Argentina. These countries are aware of the situation and take advantage of it by requesting large amounts of money in exchange for commitments. These commitments, however, are often not even worth the paper on which they are written.



Another consideration is the risk that such a portfolio concentration generates. As we can see in Chart 3, some countries are already getting close to their exposure limits. Additionally, in 2001, the credit quality of World Bank's loan portfolio deteriorated, reflecting a net deterioration in the risk ratings assigned to World Bank borrowers. This may limit the capacity of the World Bank to respond to demands for new funding.

The IDB is facing a potentially more serious limitation in its capacity to lend to the Region, because its exposure to Argentina, Brazil, and Mexico is even higher.

Looking at the recent trends in MDBs' portfolios, the concentration will probably become even worse. The deepening dependency of MDBs on these major borrowers could in the next few years have a negative effect on the viability of MDBs, if one of these countries were to default on its debt.¹¹

¹¹ In reality, this has already happened with smaller countries such as Ecuador, or with rogue states such as Yugoslavia. However, the lenient bylaws of the MDBs make it extremely difficult for a country to default on its debt. The recent announcement of the IFC to put aside some provisions to respond to a

V. SUPPLIERS

A. *Financial Constituencies*

As previously mentioned, the financial strength of MDBs is based on the support they receive from their shareholders as well as its array of financial policies and practices. Shareholder support is reflected in the capital backing MDBs have received from their members, and in debt servicing obligations.

To raise funds, MDBs issue debt securities in a variety of currencies to both institutional and retail investors. These securities are generally rated “B” or higher, and in the particular case of the World Bank they are rated “AAA”. These borrowings, coupled with their equity, are used to fund lending and investment activities as well as general operations.¹² MDBs working in Latin America and the Caribbean Region hold their assets primarily in U.S. dollars, Euros and Japanese Yen. They mitigate their exposure to exchange rate risks by matching the currencies of their liabilities with those of their assets.

Because government shareholders back MDB portfolios, they are an extremely solid and conservative investment alternative, similar to T-bonds. Absent a major problem in the international financial system, the relationship with the financial suppliers does not seem to be an issue. However, we should keep in mind that if some of the larger debtors (such as Argentina) were to default on MDBs, the situation could change and the bonds issued could lose their ratings. This would undermine the capacity of MDBs to fulfill their role.

B. *Political Constituencies*

The anti-globalization movement has created an increasingly hostile environment for MDBs in general, and for the World Bank in particular. This climate has manifested itself during the gatherings MDBs have organized for their shareholders. Beyond the anecdotal evidence, the main

possible default on some of its investments in Argentina is a clear sign that this is scenario is becoming probable scenario.

12. See WORLD BANK VOLUME 2 FINANCIAL STATEMENTS, available at <http://www.worldbank.org/annualreport/2001>; see also IDB PART II FINANCIAL STATEMENTS, available at <http://www.iadb.org/aboutus>.

danger for MDBs lies in an erosion of public opinion in donor countries.¹³ This loss of support could have a long-term impact on:

- The capacities of the MDBs to raise capital and therefore keep their high credit rating.
- Their capacities to attract and hire new staff into the institution from top universities. This is particularly dangerous, because without its human capital and their capacity to present innovative responses to the needs of their clients, the MDBs become just another source of funding in the market.

C. Conservative Forces

The recent trend in some of the larger shareholders towards an increased unilateralism and politicization of MDBs' activities is evident in the day-to-day activities of MDBs, as well as in the policy discussions in some of these countries.¹⁴

In this context, some academics from conservative constituencies in the U.S. have proposed changing the system of MDBs by reducing their number and by having the MDBs provide grants instead of loans. Although opposed by most shareholders (with the exception of the U.S.), even the partial implementation of this proposal could have a negative impact on the development community as whole and on the credibility of the MDBs. However, despite these debates and the attacks on the MDB system, I would hypothesize that for the next few years the power relations will be balanced in favor of the industry more than the suppliers.

D. Potential Entrants

The capacity to enter this market is extremely difficult. From the public sector perspective, some governments tried to create new MDBs to satisfy specific needs of a group of countries or sectors of the economy. However, due to the extremely high capital requirements and the need to rely on the political support of the constituencies in capital providing countries, the chances for such an initiative are low. For example, the MERCOSUR trade pact (formed by Argentina, Brazil, Paraguay, and Uruguay) tried to create a sub-regional development bank similar to the

13. See 50 YEARS IS ENOUGH: THE CASE AGAINST THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND 44-95 (K. Danaher ed., 1994) (describing the effects of the World Bank on various nations and the lack of progress that these nations have made).

14. See SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 106TH CONG., REPORT ON THE INTERNATIONAL FINANCIAL INSTITUTION ADVISORY COMM. (COMM. PRINT 2000).

CAF. However, due to a significant lack of capital, the initiative never materialized.

It seems simple for a private investment fund to enter the international capital markets for sovereign debt lending. However, looking at the existing risks and the limited capacity to identify potentially viable investments in recipient countries, such an initiative becomes extremely complex and daring. Based on this risk, the threat of entry to this market is rather low.

E. Substitutes

Potential substitutes of MDB's are official funds provided by Governments through official development assistance ("ODA") and non-governmental organizations ("NGOs"). ODA is mentioned as a potential substitute, in the form of grants, for lending activities of MDBs. Currently, around fifty billion U.S. dollars are channeled through official development assistance from OECD countries and other multilateral institutions towards emerging economies.

Compared to ODA, the twelve billion dollars provided by MDBs seems rather low. However, the comparison changes dramatically if we consider that the fifty billion dollar figure includes military aid, including that provided by the U.S. to Israel, Egypt, Colombia and other countries. ODA funds are either channeled through bilateral government institutions such as USAID, GTZ, Canadian International Development Agency ("CIDA"), and the U.N. system or through NGOs. Nevertheless, due to ODA's highly politicized nature, its low per capita graduation threshold, and the nature of its grants, the potential for ODA to replace MDB lending to Latin America and the Caribbean Region is rather low.¹⁵

F. Bilateral Aid

Conditions tied to bilateral aid are so stringent that it becomes, in many cases, extremely difficult for the recipient to use the resources. This often occurs when the resources are targeted at lower income countries. In the Latin America and Caribbean Region, ODA plays an even smaller role due to the relatively higher GDP/per capita levels of the region.

Bilateral aid is also perceived as a complement to resources provided from the MDBs, and not as a substitute. The reason for this is that (with the exception of military aid) grants are normally smaller and targeted towards

15. The situation may change if we were to consider the concessional arm of the World Bank IDA. Here ODA may replace at least partially the activities of the World Bank.

specific activities, whereas MDBs use a more programmatic approach. Grant money based on non-economic considerations is also provided to projects that are not viable from an economic perspective.

G. U.N. Agencies

Funding provided to U.N. agencies is considered part of ODA flows. Once again, the nature of the projects and levels of funding provided to the countries are different from the resources provided through the MDBs. The main difference is the fact that grant money is mainly used for projects that otherwise would not be viable from an economic perspective.

Politically, MDB and U.N. boards have agreed on a division of labor; establishing a close cooperation between the United Nations Development Program (“UNDP”), United Nations Children’s Fund (“UNICEF”), the FAO and the MDBs. This facilitates the complementary use of resources and the maximization of returns in terms of measurable and non-measurable outputs. Ultimately, from a financial point of view, resource allocation provided by the U.N. agencies to Latin America and Caribbean regions is so small (in absolute and relative terms) that it minimizes the threat of substitution for MDBs.

H. Non-Governmental Organizations (“NGOs”)

The NGO movement has gained momentum since the United Nations Conference on Environment and Development in 1992. NGOs have become extremely active in advocating, funding, and implementing projects on the ground. Donor governments have also decided to fund some of their activities through NGOs, because they feel they are more responsive to the needs of people on the ground.

Despite the fact that these organizations have become effective in doing their task at the field level, they have not been able to expand their functions or mandates to compete directly with MDBs. Although some NGOs would like to see MDBs disappear from the face of the earth, they would not be able to replace them. Thus, due to the nature of their funding, the NGOs compete more with U.N. agencies than with the loans from MDBs.

Additionally, one donor country is pushing the MDBs to provide part of their resources through grants and not loans in order to channel them through NGOs. Despite the fact that this could endanger the long term sustainability of the concessional lending arm of the MDBs, while also compromising the development effectiveness of their activities, this would

constitute more of a threat of substitution for the NGOs and U.N. system than a replacement of the MDBs.

VI. CONCLUSIONS AND RECOMMENDATIONS

- Due to the lack of differentiation, rivalry will remain high over the next years.
- Demand for lending from MDBs, in particular Argentina, Brazil and Mexico will increase over the next years.
- MDBs will have to take some action to diversify their portfolios in order to avoid seeing their credit ratings affected. One way to achieve this risk diversification could be achieved through:
 - An increase in the number of loans and diversification across the Region (in particular away from Argentina, Brazil and Mexico and more towards Peru, Ecuador, El Salvador, etc.) combined with a reduction of their average size.
 - For Argentina, Brazil, and Mexico, new lending instruments could be considered to support countercyclical policies without increasing ex ante the exposure to these countries.
 - Increase flexibility in MDBs' project based lending activities, moving from individual projects to a programmatic sector-wide approach.
- In order to promote their own political agenda, (reaching MDBs) and to respond to their political constituencies, MDBs should diversify their lending towards lower to middle income countries in the region such as Peru, Ecuador and Colombia, where their development impact could be higher.
- Reduce the processing time of MDBs' loans and their preparation costs, making them more competitive with other private and public institutions.
- Strengthen MDBs' knowledge base and advisory work in the countries of the Latin American and Caribbean Region.
- Due to the political pressure of some constituencies, an increase in rivalry between the IDB and the World Bank can be expected. Thus, MDBs should strengthen their political outreach activities to constituencies in developed countries to counterbalance arguments for their radical reform.