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Working Paper
World Bank, Inter-American Development Bank, and subregional development banks in Latin America: Dynamics of a system of multilateral development banks

ADBI Working Paper, No. 380

Provided in Cooperation with:
Asian Development Bank Institute (ADBI), Tokyo

Suggested Citation: Prada, Fernando (2012) : World Bank, Inter-American Development Bank, and subregional development banks in Latin America: Dynamics of a system of multilateral development banks, ADBI Working Paper, No. 380, Asian Development Bank Institute (ADBI), Tokyo

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Suggested citation:


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An earlier version of this paper was presented at the ADBI / RSIS Conference “The Evolving Global Architecture: From a Centralized to a Decentralized System”, held in Singapore on 26–27 March 2012.

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Abstract

Multilateral development banks (MDBs) are an innovative institutional model to channel financing and knowledge to developing countries. In Latin America, the balance of forces between competition and collaboration among MDBs and other sources of development finance have formed a system that is decentralized and client-oriented. We analyze three types of relationships between MDBs to show areas of strength in their operations and future potential. For this, we use a great amount of quantitative data from the annual reports and financial databases of MDBs that the FORO Nacional Internacional research program has been tracking periodically.

The three types of dynamics between these institutions are (i) division of labor between MDBs and comparative advantages; (ii) finding a balance between financial strength, internal costs, and development effectiveness; and (iii) deciding on the distribution of net income to create capacities to provide services to member countries.

JEL Classification: F34, O1, O19
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1. INTRODUCTION

This document for the RSIS–Asian Development Bank Institute (ADBI) conference is a summary of the working hypothesis and main conclusions of an ongoing research program at FORO Nacional Internacional. The main objective of the program is to identify long-term trends and dynamics of the system of international development finance (Bezanson, Sagasti, and Prada 2005).

Among the actors that participate in this system, the multilateral development banks (MDBs) are an innovative institutional model to channel finance and knowledge to developing countries. They are international financial intermediaries whose shareholders include both borrowing developing countries and nonborrowing donor countries. MDBs have three functions: (i) to mobilize resources from private capital markets and from official sources to make loans to developing countries on better-than-market terms; (ii) to generate knowledge on and provide technical assistance and advice for economic and social development; and (iii) to furnish a range of complementary services, such as international public goods, to developing countries and to the international development community (Sagasti with the contribution of Prada 2002; Sagasti and Bezanson 2000).

MDBs operating in the Latin America and Caribbean (LAC) region have formed a dense network of institutions, where competition and complementation have been the main drivers of their evolution during the last 50 years. In a previous document (Sagasti and Prada 2006), we argued that the LAC region has great potential for decentralization compared to other regions because of the strength of its regional and subregional institutions. Certain dynamics contribute to realizing this potential: (i) the interaction between MDBs and other sources of development financing, (ii) the division of labor between MDBs and their search for comparative advantages, (iii) an improved financial situation and capacity to mobilize financial resources, (iv) innovation in financial instruments and customization of their interventions, and (v) patterns of allocating net income in concordance with negotiations among stakeholders and institutional decisions.

This paper focuses on the analysis of statistical data from MDBs to describe these trends in the LAC region. In general we prioritize the dynamics between the World Bank and the Inter-American Development Bank (IDB), but recognize the growing importance of three subregional institutions—the Andean Corporation of Finance (CAF), the Central American Bank for Economic Integration (CABEI), and the Caribbean Development Bank (CDB)—as facilitators of South–South cooperation and platforms for triangular cooperation (Prada, Casabonne, and Bezanson 2010). The paper is organized as follows:

- The first part presents the relative position of MDBs in the LAC region regarding their financial role and how they offer a set of instruments to channel resources and knowledge to countries in the region.
• The next section analyzes the dynamics that are contributing to deepening the process of decentralization, with three questions in mind: (i) what are the main trends identified from observable variables; (ii) how have the most relevant institutional guidelines evolved recently; and (iii) what are the main areas for future research.

• The third part presents recommendations and conclusions about MDBs in the LAC region, and how they can increase collaboration and promote collective action.

2. THE RELATIVE POSITION OF MULTILATERAL DEVELOPMENT BANKS IN LATIN AMERICA AND THE CARIBBEAN

Financing development in the LAC region has radically changed in the last forty years and, as Figure 1 suggests, the importance of official flows has decreased relative to other sources of financing. First, net private flows now represent more than 90% of total financial flows. Despite periods of upsurge of official flows in the wake of financial crises—the debt crisis in the mid-1980s, the United States rescue after the Mexican Tesobonos crisis in 1995, the Asian and dot.com crises, and the beginning of the global financial crisis in 2008—the LAC region mostly relies on foreign direct investment, equity investment, remittances, and, to a lesser extent, official sources—particularly MDBs—to finance development.

Figure 1: Financial Flows to Countries in Latin America and the Caribbean as a percentage of total financial flows, 1970–2010

Source: Own elaboration with World Bank’s Databank.
Before 2008, official financial flows became negative due to prepayments to MDBs and debt relief operations with bilateral and multilateral creditors. Moreover, most countries in the region have been reducing their external debt–gross domestic product (GDP) ratio, and some of them have been able to diversify their access to other financial sources, including issuing bonds in international capital markets. The case of Peru is an example of such diversification and of how the relative position of MDBs has changed as a consequence (Annex 1).

Second, the capacity to mobilize domestic resources to finance a country’s development is growing rapidly. On the one hand, the public sector collects more fiscal revenues and takes debt from domestic capital markets. Fiscal revenues grew 60% between 2005 and 2011 for all countries in the region, while in Brazil, Bolivia, and Peru they doubled. Domestic public debt increased 45% on average in the same period, while in Brazil, Mexico, Peru, and Uruguay domestic debt doubled. On the other hand, domestic credit to the private sector as a percentage of GDP increased from 27% in 2000 to 42% in 2010, mainly due to a 40% growth in domestic credit to the private sector in Brazil, Chile, Colombia, and Mexico between 2000 and 2010.

With more financial sources and domestic resources available, financial flows from MDBs to LAC countries have declined. Net flows from the World Bank and IDB became negative after 2003 (Figure 2a), partially as a consequence of prepayments from countries such as Argentina, Brazil, and Mexico. This trend reversed after the global financial crisis as these two banks increased their lending to the region. Although there is no comparable data of net financial flows from all subregional development banks (SRDBs), the CDB increased net flows to Caribbean countries from US$50 million in 2007 to US$240 million in 2010, while IDB net flows to the same countries grew seven times to US$700 million in the same period (Figure 2b). The CAF has also increased its lending and thus contributed to the surge of MDB flows to the region after the global financial crisis. As Figure 3 indicates, commitments to the region increased during 2008 and 2009 as a consequence of the financial crisis, and then fell slightly in 2010. Preliminary data for 2011 and the first quarter of 2012 suggest that commitments will be lower than 2008–2009 levels.

A paradoxical situation emerges for the next 10 years regarding the position of MDBs in financing development in the LAC region. On the one hand, most LAC countries have been able to diversify their access to financial sources. Moreover, financial needs have eased as the fiscal and current account positions of most LAC countries have remained strong throughout the global financial crisis. On the other hand, MDBs are increasing their capacity to serve the region; most MDBs operating in the region—the Central American Bank for Economic Integration (CABEI), CAF, CDB, and IDB—have increased their lending capacity, and the World Bank board authorized capital increases in the 5 years to 2012. This new capacity is not only about taking the precaution of having additional funding in case the international context worsens, we argue it is also about real confidence in the region’s long-term prospects and the
ability of the MDBs to find niches to continue supporting the region through a sustainable business model.¹

**Figure 2: Net Flows from Multilateral Development Banks to Countries in Latin America and the Caribbean**

(a) To Latin America  
(US$ billion)  

(b) To Central America and Caribbean  
(US$ million)  

CDB = Caribbean Development Bank, IDB = Inter-American Development Bank.

Source: World Bank’s DataBank, Global Development Finance and annual reports from institutions.

¹ MDBs have been rethinking their relative position in the region, and most conclude that the current starting point offers great potential. For example, see Moreno (2012), CAF (2010), and World Bank (2011, 2012) on how these institutions have reassessed actions and strategies to support the region.
Figure 3: Annual Commitments of Multilateral Development Banks, 2000–2010
(by institution, US$ billion)


Notes: (i) IDB annual reports 2003, 2010; loans and guarantees approved.

(ii) Operations approved from IIC annual reports (AR). AR2009 shows US$374.80 million approved in direct loans and investments, and US$363.00 million in cofinancing operations, AR2009 shows US$299.00 million approved in direct loans and investments, and US$342.00 million in cofinancing operations, AR2008 shows US$300.50 million approved in direct loans and investments, and US$300.60 million in cofinancing operations, AR2007 shows US$470.00 million approved in direct loans and investments, and US$273.00 million in cofinancing operations, AR2006 shows US$337.68 million approved in direct loans and investments, and US$173.00 million from other sources.

(iii) CABEI reports: AR2003 and AR2006 consider net loan approvals, which result from deducing debt obligations from gross approvals, and other years’ figures correspond to total approvals.

(iv) Loans, grants, and equity are included.

(*) Figures are not comparable since not all multilateral development banks have operations in all countries: IDB has operations in all 26 countries of the Latin America and Caribbean region; the CAF in 16 countries (Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Jamaica, Mexico, Panama, Paraguay, Peru, Dominican Republic, Trinidad and Tobago, Uruguay, and Venezuela); CABEI in Belize, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Panama; and Argentina and Colombia outside the subregion, and; CDB in Anguilla, Antigua and Barbuda, the Bahamas, Barbados, Belize, British Virgin Islands, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Trinidad and Tobago, and the Turks and Caicos Islands.
The innovation capacity of MDBs and the growth prospects of the region have the potential to generate a virtuous circle in the coming years in favor of LAC countries. The global financial crisis only temporarily moderated the trends regarding the relative position of the MDBs in the region, and, as a consequence, several questions and debates that took place in a precrisis context are back in 2012. The first group of questions relates to what precisely to do with increased MDB lending capacity in relation to countries’ absorptive capacity and access to other financial sources; the second group of questions relates to what is an adequate balance between the three MDB functions for the region, and whether MDBs can offer financial and nonfinancial services to perform these functions. Our response to both questions is that having a decentralized and financially healthy network of MDBs that compete and collaborate at different levels gives the region a comparative advantage to deal with these issues.

The number of MDBs operating in the LAC region is higher than in any other global region, and most of them have been operating here since before 1980 (Figure 4). Along with the World Bank and IDB group of institutions, which have regional scale and serve all countries in the region, there is a group of SRDBs and extraregional MDBs that cover only a limited number of countries. Combined, these institutions form an MDB system that serves a variety of clients from the private and public sector. All developing countries in the region, except Cuba, work in parallel with the World Bank, the IDB, and at least one SRDB. This feature gives the system competition at the country level: MDBs need to find comparative advantages and differentiation from other MDBs, other sources of financing (e.g., domestic and international capital markets), and other development institutions (e.g., bilateral donors, private foundations, and social responsibility and nongovernment institutions).
Figure 4: The Global System of Multilateral Development Banks


Source: Author’s elaboration
This system of MDBs has been slowly consolidating in the LAC region, while successful but isolated cases of collaboration and collective action between MDBs are emerging and becoming more frequent. Nevertheless, a description of such system 10 years ago is still accurate:

...far from functioning as an integrated system, it must be said that the MDBs currently behave more like a dysfunctional family, primarily in the field. Relations between the World Bank and the regional development banks are strained in several regions and in many countries, while most sub-regional MDBs have little interaction with the World Bank. Differences in management styles, extent of field presence, relations with borrowers, technical competence, knowledge of the region and countries, among others, combine to create sources of tension that could and should be reduced by taking a more systemic approach to the operations of MDBs. (Sagasti and Bezanson 2000, 68)

As we indicate in the next section, the system of MDBs in the LAC region has benefited from subregional dynamism and strength—a unique feature of the LAC region compared to other regions. This generates forces for competition, particularly at the country level, but at the same time opportunities for regional collaboration. On the one hand, there are more and more cases of pool-funding and shared projects between MDBs throughout the region (e.g., pool-funding for Haiti reconstruction, where the IDB had a lead role in catalyzing additional financing from a large variety of development institutions). On the other hand, the IDB has also taken a proactive approach to supporting development banks at the subregional level. For example, it supported the CDB with institutional credit of US$20 million in 1996 for capital strengthening, and it has recently provided technical assistance to the Financial Fund for the Development of the River Plate Basin (FONPLATA), which has resumed its credits to the common market of the Southern South American region (MERCOSUR). However, how countries benefit from these dynamics of collaboration and competition between MDBs depends on specific country cases.

Using a systemic approach, we indicate that the diversity of MDBs is positive, given the diversity of countries in the region. The fact that almost every country in the region is a middle-income country according to World Bank categorization hides deep differences between them. We have recently updated our index of capacity to mobilize external and domestic resources (Figure 5), which is an alternative to income-based rankings. Most LAC countries are well positioned among the top, but some groups of countries can be distinguished: Argentina, Brazil, and Mexico (due to the size of their economies); Caribbean islands such as Dominica; other South American countries; and Central America (except Mexico).

MDBs in the LAC region are becoming more responsive to these signals and are moving towards customizing their interventions on a country-by-country basis, thus enforcing a client-
oriented culture of MDBs in the region. The World Bank’s updated strategy for the region (World Bank 2011) is clustering different sets of interventions and services to four groups of countries according to income and additional dimensions such as the size of economy and particular vulnerabilities. The IDB has made significant investments to decentralize operations during its “realignment” process, and nowadays its country offices have more responsibilities, resources, and personnel. Having strong SRDBs also allows for a degree of specialization and a diversity of approaches at the country level.

**Figure 5: Capacity to Mobilize External and Domestic Resources, 2010**

A working hypothesis of our research program indicates a strong relationship between the capacity to mobilize domestic and external resources, and the structure of sources of development financing that countries choose. Our case study on Peru (Annex 1) presents evidence on how the capacity to mobilize external resources has evolved, and how the related financial structure of its capital account has changed over 40 years. Therefore, the position of

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3 Annex 1 presents partial results since we have only considered Peru’s capital account data, i.e., related only to its capacity to mobilize external resources. It is clear though that the Peruvian public sector in the 2010s relies more
MDBs relative to other financial sources changes as countries increase their capacity to mobilize domestic and external resources to finance development.

As a response, MDBs have had strong incentives to extend and improve the set of instruments through which they channel financial resources and knowledge to the LAC region. Sagasti and Bezanson (2000) argue that MDBs enjoy a strategic position in the field of development finance and this increases their potential to innovate in development approaches and financial instruments. Not only do MDBs in the region operate within the international financial system, but they also partner with a number of institutions such as United Nations agencies, bilateral assistance agencies, private foundations, the International Monetary Fund, and emerging donors such as the People’s Republic of China (PRC).

MDBs offer a set of financial instruments for diverse demands (Table 1). In addition to traditional loans and grants, the World Bank and IDB have introduced (i) results-based loans that disburse tranches conditional on achieving improvements in agreed indicators on social or policy outcomes; (ii) a set of financial instruments such as guarantees, equity investments, and small and medium-sized enterprise (SME) support to mitigate risks for private investors; and (iii) fast-disbursement loans and grants for disaster relief. SRDBs in the region are also part of this innovative trend. The CAF has a comparative advantage in structuring financing for large infrastructure projects by catalyzing funds from multiple private investors and investment funds due to its closeness to international capital markets. Other SRDBs are introducing innovations in microfinance and SME financing with instruments such as loans to financial intermediaries, financial support to productive chains and producer associations, and creation of domestic capital markets.

In summary, three main forces will shape the future of MDBs in the LAC region:

- the capacity of MDBs to innovate in approaches and financial instruments to address the diversity of demands of their member countries and clients from the private sector,
- the capacity of countries to mobilize domestic and external resources that impact the relative position of MDBs in the development financing landscape, and
- the balance between competition and collaboration among MDBs in their quest to find niches and their comparative advantages.

on domestic capital markets and public revenues to finance public investment, while before 1980 it relied on MDBs or syndicated loans from private banks (later converted into Paris Club debt).
Table 1: Multilateral Development Banks and Financial Instruments

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<td>Tenders</td>
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<td>Pre-investment and technical cooperation</td>
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<td>Loans: A/B and syndicated</td>
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<td>8.</td>
<td>Programs: Educational, SMEs, technical and financial cooperation, municipal infrastructure funding, financial intermediation for housing</td>
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<td>Specific projects</td>
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<td>• Investment loans: specific loans and predefined activities, as innovation, training, equipment</td>
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<td>• Policy-based loans: for institutional and policy reforms</td>
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<td>• Emergency loans: for financial crises and natural disasters</td>
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<td>2.</td>
<td>Nonsovereign guarantee loans</td>
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<td>3.</td>
<td>Grants: Trust fund grants, Multilateral Investment Fund grants, and Social Entrepreneurship Program</td>
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<td>• Private sector guarantees: credit guarantees and political risk guarantees</td>
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<td>5.</td>
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<td>6.</td>
<td>Flexible financing (Ordinary Capital): Flexible financing facility and local currency financing</td>
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Source: Annual reports of institutions.

3. THE DYNAMICS OF MULTILATERAL DEVELOPMENT BANKS IN LATIN AMERICA AND THE CARIBBEAN

There are no common metrics to assess the level of decentralization of the MDB system in each region. Our hypothesis is that an MDB system is more decentralized as it shows more strength and dynamism at the subregional level in dimensions that are comparable across institutions and regions. We are analyzing three dimensions in this section: (i) division of labor; (ii) financial strength and institutional capacity to provide services at affordable costs for countries and clients; and (iii) managing net income to address specific needs of member countries, clients, and stakeholders.

3.1 Division of Labor: Finding Niches and Comparative Advantages

To provide services to member countries, MDBs need to acquire specific skills, make available financial and human resources, and establish institutional guidelines that connect their mission
with their activities at the country and regional level. Most of the studies about this issue, particularly those describing the operations of the World Bank and regional development banks, coincide in two ideas: (i) that the individual institutional missions are very broad and have tended to increase over time, a feature known as “mission creep”; and (ii) a significant part of MDB missions are shared with other MDBs, which tend to work in parallel with little coordination or harmonization of their procedures at a country and regional level. If this diagnostic is entirely correct, then the prospects of a division of labor based on comparative advantages among MDBs within a region are unpromising.

This framework has been popular at describing the relationship between Bretton Woods system institutions, such as the World Bank and the International Monetary Fund, and other institutions such as the organizations of the United Nations system and, to a lesser extent, regional development banks—SRDBs have been generally excluded from this debate. Nevertheless, we argue that a country-level perspective on division of labor provides a more accurate picture of the forces that drive competition and collaboration between MDBs in the LAC region.

During the 2000s, MDB operations were more concentrated in sovereign borrowers and, therefore, the debate was centered on whether the borrowing capacity of their clients would become a limit for the sustainability of MDBs’ business model. This scenario has not materialized because countries have been able to increase their absorptive capacity as their economies have grown. Therefore, there has been room to maneuver and SRDBs have been able to find their own niches. Figure 6 shows that the CABEI, CAF, and CDB are able to mobilize resources to LAC countries on a scale comparable to the World Bank and the IDB, representing a bigger percentage of total commitments.

De la Torre and Ize (2010) posit an interesting argument about the comparative advantages of MDBs regarding their lending role: since MDBs are neutral to risk, they are able to spread risk more efficiently compared to risk-averse private sector lenders. As a consequence, they can expand the credit frontier by innovating in different sectors and experimenting with new approaches. This argument can be extended to the different attitudes to risk between MDBs and helps explain the logic behind the dynamics of the sector division of labor of MDBs in the LAC region.
Figure 6: Multilateral Development Bank Lending Commitments to Selected Countries, 2010

CAF = Andean Corporation of Finance, CDB = Caribbean Development Bank, IDB = Inter-American Development Bank.
CABEI = Central American Bank for Economic Integration.

Source: Annual reports of institutions.

Figure 7 shows how SRDBs tend to focus on infrastructure, power, energy, and water, while the World Bank and the IDB concentrate on social services and support to the public sector and civil society. During the 1980s, there was a similar division of labor between the World Bank and the IDB—the IDB started its operations in the 1960s with a heavy focus on the productive sector that represented only a small percentage of the World Bank’s lending to the region, which was more focused on infrastructure during that period (Sagasti 2002, 14). For example, the environment and support to the public sector are areas that SRDBs have not fully entered, while the World bank and the IDB are investing heavily.

Therefore, as MDBs consolidate in the LAC region, they are progressively designing more complex interventions and venturing into sectors where they are willing to take more risks. However, SRDBs are often able to catch up, innovate, and create a niche for themselves even in sectors such as infrastructure. For example, the CAF has been able to take advantage of its flexible decision-making process and has gained expertise in catalyzing financing for large infrastructure projects. In the case of the CDB, it has been able to allocate emergency funding for disaster relief in a subregion frequently hit by hurricanes (multisector in Figure 7).
Figure 7: Division of Labor by Sector, 2000–2010

CAF = Andean Corporation of Finance, CDB = Caribbean Development Bank, IDB = Inter-American Development Bank. CABEI = Central American Bank for Economic Integration.

Notes: (i) Classification for World Bank and IDB are based on CRS sectors: transport and storage and communications are Infrastructure; agriculture, forestry, fishing, industry, mineral resources and mining, trade policies and regulations, and tourism are Productive Sector; water supply and sanitation and energy are Power, Energy and Water; education, health and population policies and programs, and reproductive health are Education, Health, and Social Services; other multisector, reconstruction relief and rehabilitation, and disaster prevention and preparedness are Multisector and Other; banking and financial services, and business and other services are Financing and Business; and government and civil society - general and conflict, peace, and security are Public Sector and Civil Society.

(ii) CAF: Agricultural infrastructure and transport, storage, and communications are Infrastructure; mining and quarrying and manufacturing are Productive Sector; development institutions and other are Multisector and Other; and commercial banking is Financing and Business.

(iii) CDB: Transportation and communication are Infrastructure; agriculture, forestry, fishing, manufacturing, and tourism are Productive Sectors; social and personal services are Education, Health, and Social Services; and financial is Financing and Business.

(iv) CABEI: Infrastructure, municipal infrastructure, transport, storage, communications, and hotels are Infrastructure; trade, manufacturing, agriculture, ranching, fishing, hunting and forestry, oil and gas, and productive sectors are Productive Sector; education, social services, and health are Education, Health, and Social Services; computing, other services, regional body and multisector are Multisector and Other; real estate and financial intermediation are Financing and Business; and public administration is Public Sector and Civil Society.
There are sectors where competition is intense as MDBs are willing to expand their client base and move away from their sovereign focus. This applies to operations with the private sector and, to a lesser extent, the new financial instruments, such as public–private partnerships, to mobilize resources from capital markets for infrastructure. Even though the World Bank and the IDB have specialized agencies to work with the private sector, they have funded operations with ordinary capital—a normal procedure in the case of SRDBs.

The International Finance Corporation (IFC) of the World Bank lent US$3.1 billion in financial year (FY) 2011, up from US$1.9 billion in FY 2000, but lending has not since reached the FY2008 peak of US$4.5 billion during the global financial crisis. The IFC allocates 25% of its total lending to the LAC region. The IDB has two specialized agencies for its private sector operations: the Multilateral Investment Fund (FOMIN) and the Inter-American Investment Corporation (IIC). During its 2011 annual meeting in Calgary, the IDB presented its new strategy for development of the private sector, with the aim of streamlining its operations. The strategy includes several programs to develop capital markets in less-developed countries, increase funding to SMEs, promote financial inclusion, finance “bottom of the pyramid” initiatives, support microfinance and micro-insurance institutions, and help companies transition to a lower-carbon mode of production. The IDB allocated US$2.9 billion to the private sector in 2011, the IIC allocated US$465.0 million, and FOMIN allocated US$108.0 million.

SRDBs are also innovating and competing in these areas and complementing the operations of other MDBs. The CAF has been very active and is currently providing support to multilatinas, providing capital to companies to initiate operations in other countries, and acquiring equities from companies to finance their expansion. In 2010, the support to private sector operations was US$2.8 billion, representing 20% of the IDB’s total allocations. CABEI has been focusing on supporting the private sector in Central America and promoting private investment, and this now represents 25% of its annual commitments (US$300 million). The CDB has a small Private Sector Development Division (5% of total commitments), which has been directed to support the development of mortgage markets and loans to institutions to provide student financing.

There is a strong case for collaboration between MDBs in specific areas. First, their research on development issues is becoming an important source of reference, but duplication of efforts in some areas should give rise to more collaborative efforts, peer-reviewed studies, and joint publications and evaluations. Second, although there is only anecdotal evidence, regional epistemic communities are emerging as a consequence of knowledge exchange. Each MDB is making efforts to create capacities in the public sector and support managers and consultants.

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4 This term refers to the main transnational companies from LAC countries.
in organizing seminars to exchange information and provide technical cooperation. Harmonizing approaches and coordinating areas of support could increase the capacities of public officers through a more efficient use of resources. Third, MDBs are part of a financial innovation that is still strong, but the changes in the international system of financing development are posing several threats to their operations: they could be carrying out several exercises to think together about their future and their position regarding topics such as regional development, support to the private sector, and countercyclical role.

There are other relevant topics regarding division of labor that are starting to become part of the debates about the future of MDBs. There is anecdotal evidence that some countries have been able to take leadership of their relationship with donors (Wood et al. 2011) and effectively manage their negotiations with MDBs. However, this information has been poorly systematized but it could provide interesting insights into patterns of countries managing their relationship with MDBs and assess how client-oriented the regional MDBs are. It is frequently claimed by MDBs in the LAC region that competition from other international financial institutions creates an environment conducive to a more client-oriented behavior from these institutions; but again, this claim is only supported by anecdotal evidence and not by analytical studies.

Another area of research relates to epistemic communities that MDB contributions are consolidating through technical assistance support. The communities are important because they have contributed to generating strong consensus in public policies in certain areas such as macroeconomic management, and could be crucial in improving the skills of public officers. Understanding this dynamic could provide insight into how to improve the role of generating and providing knowledge to countries through technical assistance.

A third area of research is the role of MDBs as platforms for regional integration and international cooperation, particularly the case of South–South cooperation and triangular cooperation. MDBs in the LAC region are unclear about their specific role in this area, and are engaging in a series of reflections on these topics. MDBs have advantages in channeling cooperation between developing countries because of their networks and presence in countries, and can contribute to advancing the agenda of the Paris Declaration on Aid Effectiveness by helping new donors to design and implement cooperation programs.

3.2 Delicate Balances: Financial Strength, Low-Cost Lending and Services, and Development Effectiveness

MDBs have been building a strong financial position, and years of responsible management are reflected in their financial statements. Table 2 presents the risk-bearing capital ratio
First, the IDB and SRDBs have expanded their net outstanding loans to the region, but those of the SRDBs have grown at a faster pace. While IDB net loans to the region grew 42% between 2002 and 2010, net loans from SRDBs grew steadily and more than doubled—the CAF’s loans expanded by 145%, CDB’s by 115%, and CABEI’s by 108%. The IDB experienced a slowdown after 2003, and its net loans to the region only recovered after the global financial crisis. Second, retained earnings have followed a similar trend: they are growing for all MDBs in the region, but those of SRDBs are growing at a faster pace.

Third, the RBCR indicates that there is enough room for MDBs to increase their lending without compromising the strength of their financial ratios. A high RBCR indicates high leverage, and a low RBCR indicates additional room to increase lending compared to levels of operating capital. This ratio has followed a common pattern: RBCRs reached a peak around

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**Table 2: Financial Indicators of Multilateral Development Banks (US$ million) and their Risk-Bearing Capital Ratio (points), 2002–2011**

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<td>116,075</td>
<td>111,762</td>
<td>105,626</td>
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<td>11,486</td>
<td>11,491</td>
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<tr>
<td>Retained earnings</td>
<td>22,227</td>
<td>27,031</td>
<td>23,982</td>
<td>27,171</td>
<td>24,782</td>
<td>27,831</td>
<td>29,322</td>
<td>28,546</td>
<td>28,793</td>
<td>29,723</td>
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<tr>
<td>RBCR</td>
<td>3.44</td>
<td>2.90</td>
<td>2.98</td>
<td>2.61</td>
<td>2.76</td>
<td>2.43</td>
<td>2.38</td>
<td>2.64</td>
<td>2.98</td>
<td>3.20</td>
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<tbody>
<tr>
<td>Net loans</td>
<td>46,397</td>
<td>50,472</td>
<td>49,643</td>
<td>47,960</td>
<td>45,842</td>
<td>47,903</td>
<td>51,037</td>
<td>57,933</td>
<td>62,862</td>
<td>65,980</td>
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<tr>
<td>Retained earnings</td>
<td>9,883</td>
<td>12,288</td>
<td>13,437</td>
<td>14,199</td>
<td>14,442</td>
<td>14,576</td>
<td>14,647</td>
<td>15,481</td>
<td>15,771</td>
<td>15,488</td>
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<tr>
<td>RBCR</td>
<td>3.26</td>
<td>3.04</td>
<td>2.79</td>
<td>2.59</td>
<td>2.44</td>
<td>2.53</td>
<td>2.68</td>
<td>2.92</td>
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<tr>
<th>Corporación Andina de Fomento</th>
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<th>2003</th>
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<td>6,863</td>
<td>7,128</td>
<td>7,849</td>
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<td>9,900</td>
<td>11,487</td>
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<td>1,319</td>
<td>1,499</td>
<td>1,682</td>
<td>1,871</td>
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<td>2,176</td>
<td>2,486</td>
<td>2,814</td>
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<tr>
<td>Retained earnings</td>
<td>771</td>
<td>888</td>
<td>1,074</td>
<td>1,316</td>
<td>1,565</td>
<td>1,878</td>
<td>2,097</td>
<td>2,262</td>
<td>2,323</td>
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<tr>
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<td>2.87</td>
<td>2.67</td>
<td>2.38</td>
<td>2.28</td>
<td>2.40</td>
<td>2.34</td>
<td>2.42</td>
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<tr>
<td>Net loans</td>
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<td>513</td>
<td>637</td>
<td>687</td>
<td>718</td>
<td>750</td>
<td>769</td>
<td>818</td>
<td>994</td>
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<tr>
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<td>157</td>
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<td>157</td>
<td>207</td>
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<tr>
<td>Retained earnings</td>
<td>234</td>
<td>256</td>
<td>277</td>
<td>296</td>
<td>314</td>
<td>349</td>
<td>423</td>
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<tr>
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<td>1.48</td>
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<td>1.45</td>
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<tbody>
<tr>
<td>Net loans</td>
<td>2,226</td>
<td>2,758</td>
<td>2,680</td>
<td>3,057</td>
<td>3,545</td>
<td>3,808</td>
<td>4,153</td>
<td>4,616</td>
<td>4,638</td>
<td>2,226</td>
</tr>
<tr>
<td>Paid-in</td>
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<td>372</td>
<td>372</td>
<td>384</td>
<td>404</td>
<td>420</td>
<td>427</td>
<td>447</td>
<td>451</td>
<td>372</td>
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<tr>
<td>Retained earnings</td>
<td>706</td>
<td>800</td>
<td>936</td>
<td>993</td>
<td>1,049</td>
<td>1,122</td>
<td>1,296</td>
<td>1,367</td>
<td>1,471</td>
<td>706</td>
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<tr>
<td>RBCR</td>
<td>2.07</td>
<td>2.35</td>
<td>2.05</td>
<td>2.22</td>
<td>2.44</td>
<td>2.47</td>
<td>2.42</td>
<td>2.31</td>
<td>2.41</td>
<td>2.07</td>
</tr>
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</table>

RBCR = risk-bearing capital ratio.

Note: RBCR is the ratio between net outstanding loans and the sum of paid capital and retained earnings.

Source: Annual financial statements of institutions.
2002 for most MDBs and have not since regained that level, even though MDBs increased lending due to the global financial crisis. The CAF, for example, has been increasing leverage and rapidly catching up to levels of the World Bank and the IDB. It is worth noting that commercial lending institutions normally have RBCR levels of 5–10, which is an indication of the prudential lending standards of MDBs.

Financial strength and prudential lending standards are key characteristics of the MDBs’ model. Because of a combination of comfortable financial levels in MDBs and a higher capacity to mobilize resources in LAC countries, early in the 2010s there is an opportunity to take more risks and experiment and innovate with new approaches. An extra opportunity is presented by historically low interest rates, and central banks such as the US Federal Reserve have indicated their willingness to maintain rates at these levels as the economies need additional support.

Figure 8 shows average lending rates of the World Bank and the IDB during 2003–2011. The global financial crisis caused a structural change in the price of London interbank offered rate (LIBOR)-based instruments for both banks, which have been stable at around 1% since 2008. In parallel, sovereign spread (the difference between the interest rate of sovereign bonds and US Treasury bonds) have returned to precrisis levels, as has the Emerging Market Bond Index (EMBI+). Although they are not strictly comparable, margins between the lending interest rates of MDBs and the average cost of financing from international capital markets have returned to precrisis levels. As was the case before the financial crisis, some countries see no comparative advantage in MDB lending interest rates because they have cheaper options. Therefore, this feature is also driving competition between MDBs and is providing MDBs with incentives to enter into more complex operations and expand their client base. SRDBs are experiencing similar pressures, but more data is needed.
Interest rates from other financial sources and MDBs were converging before the global financial crisis and most banks adjusted their internal costs so they could offer lower prices to their clients, e.g., they have adjusted front-end fees and lending spreads (Figure 8b shows these changes for the IDB). Nevertheless, this is not a sustainable strategy in the long term because development interventions tend to increase in cost as they become more complex. For example, the World Bank performs periodic analysis of its internal costs of lending instruments, and there is evidence that supervision costs for investment loans has increased over the years.6

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6 World Bank (2009, 31) indicates that “between FY04 and FY09, expenditure on supervision of the IBRD portfolio increased at around 3.6% a year, effectively flat in real terms; supervision costs for the IDA [International Development Association] portfolio increased by 9.2% a year over the same period. The net effect was to increase total supervision costs by $51.0 million.”
Although there is no data to compare administrative costs between MDBs, it is safe to affirm that administrative costs are higher as operations become more complex and competition between institutions increase. For example, decentralizing operations at the IDB after the process of realignment has implied an important reallocation of personnel and, thus, higher administrative costs, at least in the short term. But these investments are crucial to improve operations. The challenge is whether smaller MDBs are able to follow this trend. The CAF has been able to mobilize resources from extraregional partners such as the PRC and Brazil, and it is heavily investing in creating capacities for research in development topics and new approaches, attracting talent, and decentralizing offices.

A similar argument for collaboration can be made in the case of the focus on development effectiveness that most MDBs are implementing. Having impact on development indicators requires more complex operations, a stronger focus on evaluation and monitoring, enhanced institutional skills to measure internal operations, and trained personnel to carry out these tasks. It is clear that this focus relates to higher administrative costs and, so far, only the World Bank and the IDB have actively engaged in implementing these reforms (IDB 2012). Therefore, increasing collaboration and utilizing cost-sharing schemes of MDBs in this area, particularly at the country level, may contribute to reducing costs of implementing operations with a stronger focus on development effectiveness.

Some areas with strong potential for cost sharing to advance in the area of development effectiveness are (i) discussing a common framework to assess development effectiveness at the country and institutional level to ensure adequate benchmarking; (ii) engaging SRDBs in furthering the development effectiveness agenda, such as agreeing on common country operation frameworks under the leadership of borrowing countries; (iii) investing resources in guaranteeing the “evaluability” of development projects; and (iv) promoting knowledge and discussions to disseminate evidence-based interventions that can be later implemented by several MDBs in their respective subregions. The IDB and the World Bank are already implementing periodic reviews of their development effectiveness role with adequate resources and broad analysis of their operations. SRDBs need to catch up and other banks can collaborate efficiently to achieve this aim.

Some areas of research emerge regarding the delicate balance that MDBs need to find between financial strength, innovation capacity to provide services at competitive costs, and their impact on development. First, there is almost no work on comparing unitary costs of providing certain types of services across banks. Second, MDBs need to systematize their knowledge of implementing development effectiveness in their institutions, estimate their costs to implement these reforms, and estimate changes in development effectiveness with comparable indicators across institutions. Third, more work is needed to systematize innovations in MDBs that contribute to reduced administrative costs or increased development effectiveness. SRDBs are generally catching up quickly, but further systematization and dissemination efforts of these innovations can increase collaboration between SRDBs and the main banks.
3.3 **Net Income Distribution: Where Policy and Politics Meet in Multilateral Development Banks**

Decision making over net income is the area where MDB stakeholders express their preferences about the future of MDB operations. Net income is the difference between income and expenses during a determined period of operations. In general, MDBs can choose to allocate their net income between (i) improving the financial position of the institution by increasing reserves and strengthening lending capacity; (ii) providing grants, increasing concessional lending, or building fiduciary funds for specific purposes, particularly for providing international public goods, that will not generate additional income; and (iii) setting aside resources to invest in more complex operations, which tend to increase administrative expenses and, thus, reduce net income, or, in contrast, reducing fees or lending spreads to slash lending costs.

Table 1 shows that net income of MDBs operating in the LAC region have been highly variable and there is no common trend. Sagasti and Prada (2006) identified some patterns to allocate net income in regional MDBs, but the global financial crisis seems to have changed these patterns. For several years, MDBs in the LAC region have focused on strengthening their capital and lending base, and thus have prioritized building reserves and have allocated a greater share of net income to retained earnings. For example, the CDB and CABEI have consistently allocated 100% of their net income to strengthening their capital base.

The situation is more complex in the case of the IDB, and the CAF is following this path and differentiating progressively from other SRDBs while expanding operations in non-Andean countries. Until 2007, the IDB was allocating a significant part of its net income to retained earnings and a small percentage to increase resources of the Fund for Special Operations, the IDB’s concessional lending window. This has radically changed as a consequence of two related events: the creation of the IDB Grant Facility in 2007; and the beginning of the IDB-9 negotiation process in 2009, the ninth capital replenishment that seeks to increase the IDB’s capital by 70% when the process finishes by 2015.

As part of the IDB-9 negotiation processes, the IDB board of governors have pledged a US$200 million per year allocation from the IDB’s net income to strengthen the capital base of the Grant Facility until 2021. Currently, only Haiti is receiving funding from this facility, but any other poor country in the region under conditions of stress and vulnerability can apply for funding through this window. Moreover, following the catastrophic earthquake in Haiti in 2010, the IDB has mobilized extra resources from its net income—it provided full debt relief to Haiti and made a provision of US$484 million for this purpose.

For the IDB, these changes are an important sign of shifting roles and changing balances between the three functions of MDBs. With additional resources after the conclusion of IDB-9, the IDB will have extra room to expand lending without affecting its financial position. The IDB
is now investing resources to increase its capacity to provide grants to countries under financial stress, and has chosen not to strengthen its concessional window. This extra capacity will add to several funds and special programs under IDB administration on behalf of member countries for specific purposes related to the production of international public goods such as research, technical cooperation, pre-investment, and triangular cooperation.\footnote{For more details, see http://www.iadb.org/aboutus/trustfunds/fundsearch.cfm}

The CAF is also finding a balance between strengthening its financial position, making its operations more complex, and increasing resources to provide international public goods. The CAF’s Constitutive Agreement requires that at least 10% of net income should be allocated to increase reserves, but it tended to allocate slightly more before the global financial crisis. However, the CAF has been allocating almost half of its net income to special programs and funds for technical cooperation, research initiatives, and the provision of grants. For example, in 2011 almost US$100 million was allocated for this from 2010 net income (55% of total net income), in 2010 it allocated US$105 million of 2009 net income (45% of total net income), and in 2009 it allocated US$70 million of 2008 net income (40% of total net income).

Another area where politics and decision-making intersect is the decision to include nonregional partners in MDB operations. This can provide additional financial resources and new approaches, but can slightly alter the balance of power inside institutions. For example, the PRC, which joined the IDB as a member country in 2009, has pledged through its Eximbank a US$1 billion joint program to promote investment in the LAC region, but has committed 30% of this to create a fund to combat violence in the region. The PRC is already a member country in SRDBs such as CABEI and CDB (Table 3), but it is also working closely with the CAF through the Chinese Development Bank and other PRC institutions to provide syndicated loans and support investment in the LAC region. Both institutions have launched research programs and joint initiatives to work more closely with the PRC, as this country is becoming the main trading partner of several LAC countries. Nevertheless, a growing influence of such an important player may add an extra layer of complexity to MDBs affairs in the future.
### Table 3: Multilateral Development Bank Net Income, 2000–2011

**US$ million**

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<tbody>
<tr>
<td>IDB</td>
<td>846</td>
<td>1,021</td>
<td>709</td>
<td>2,433</td>
<td>1,176</td>
<td>762</td>
<td>243</td>
<td>134</td>
<td>(22)</td>
<td>794</td>
<td>330</td>
<td>(283)</td>
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<tr>
<td>CAF</td>
<td>107</td>
<td>113</td>
<td>127</td>
<td>136</td>
<td>208</td>
<td>283</td>
<td>321</td>
<td>401</td>
<td>311</td>
<td>235</td>
<td>166</td>
<td>153</td>
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<tr>
<td>CDB</td>
<td>27</td>
<td>22</td>
<td>19</td>
<td>7</td>
<td>18</td>
<td>35</td>
<td>85</td>
<td>40</td>
<td>38</td>
<td></td>
<td></td>
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<tr>
<td>CABEI</td>
<td>137</td>
<td>56</td>
<td>57</td>
<td>73</td>
<td>81</td>
<td>83</td>
<td>71</td>
<td>114</td>
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( ) = negative, CAF = Andean Corporation of Finance, CDB = Caribbean Development Bank, IDB = Inter-American Development Bank. CABEI = Central American Bank for Economic Integration.

Source: Annual Reports.

The patterns of net income allocation contribute to understanding future directions that MDBs are willing to take. While the IDB (and the CAF to a lesser extent) is setting aside recourses for more complex operations from its net income, other SRDBs are building their financial capacity to focus on their financial role. The IDB is taking the lead in the region to make resources available to countries in financial distress. It is thus creating precautionary funding options, such as the IDB Grant Facility, and working with multidonor funds such as the Haiti’s Reconstruction fund and others for specific purposes such as FOMIN as well as technical cooperation funds under its administration. As the CAF is expanding its original subregional focus and has started to provide financing to other countries such as Argentina, Brazil, Costa Rica, Panama, and Uruguay, it is also investing heavily in creating additional capacity to work with new clients and more countries.

### 4. CONCLUSIONS

Dynamism and strength at the regional and subregional level suggest that MDBs are part of a decentralized system in the LAC region. We have gathered several indicators about their interactions with other MDBs and other financial and development institutions, their relative position in the development financing landscape, and how they benefit from their comparative advantages such as different willingness and capacities to take risks. The evidence suggests that MDBs are actively looking for niches and competing with each other for relevance, financing, and influence, particularly at the country level.

Most countries in the LAC region are benefiting from the competition between these institutions for two reasons. Firstly, most of these countries have been growing (despite the global financial crisis), have improved their access to financial sources, and have comfortable room to maneuver in case the international context worsens. Secondly, they benefit from better services and customized interventions from MDBs, as well as additional insurance in case of a sudden reduction in financial flows due to a more complicated international situation. Therefore, there is a window of opportunity in the next 10 years to devote important resources to innovate in development approaches, scale-up investment to create institutional capacities
in LAC countries, and improve the provision of regional public goods. MDBs have a crucial role to play in providing knowledge and mobilizing finance.

MDBs have traditionally prioritized their financial role and have built strong reserves to operate in the LAC region, and now there are strong signals that MDBs are investing in new approaches, increasing grant resources, decentralizing, and scaling-up their operations. But financial resources are scarce in the long term, and a rethink is required of how to allocate the additional resources that are a product of the current economic growth cycle. Here, a systemic approach could be important: MDBs should think together on how to find a balance between the three functions (providing that each MDB has space for specialization) and to benefit from their own comparative advantages.

There is enough anecdotal and systematized evidence about how dysfunctional the MDB system in the LAC region can be. For each example of collaboration between these institutions, there are several examples on how they duplicate efforts, engage in costly and ineffective interventions, and support initiatives and projects with politics in mind instead of applying an adequate project evaluation, among other valid concerns.

By taking a look at long-term dynamics and identifying patterns in available data about MDBs, we conclude that there is more room for collaboration between these institutions than the conventional wisdom suggests. One reason for this is that they are facing similar threats in the current international context and, thus, have incentives to find common ideas to maintain their relevance in the future. Another reason is that MDBs are important sources and promoters of knowledge and innovation in development thinking and ideas for intervention, and they are generating frequent (and poorly recognized) collaborations between their staff, between public officers in developing countries, and with the academic community. There are significant gains in having a dense network of MDBs that promote knowledge, provide technical cooperation, and function as platforms for collaboration.
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World Bank Treasury. IBRD Lending Rates and Loan Charges.  
ANNEX 1: EXTERNAL FINANCIAL FLOWS TO THE GOVERNMENT OF PERU

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Figure A1 describes the evolution of net transfers to the Government of Peru from external creditors—new loans minus payments of interest and principal of previous ones during the same period. The main trends can be summarized as follows:

• Annual average net transfers were positive by US$420 during the 1970s and by US$150 million during the 1980s. Bilateral debt from Paris Club and non-Paris Club members and from other creditors (such as export credits, commercial banks, and credit from suppliers) maintained positive net transfers with Peru during the 1970s. After the 1980s debt crisis, the financial structure changes as debt from multilateral development banks (MDBs) and Paris Club members increased to cope with the shortage of foreign currency.


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The Peruvian debt profile has improved as a consequence and more financial options opened during the 2000s. New loans reached an average maturity of 13.4 years in 2010, while bonds reached 17.4 years. Moreover, almost 80% of total public debt has fixed interest rates. This diversification of financial sources has allowed for better debt management—in 2010 almost half of new disbursements were utilized to prepay Paris Club and MDB debt. This debt replaces old and expensive debt with new debt arising from issuing global bonds in international capital markets; Peru has been issuing bonds at an average of US$1.5 billion per year during 2000–2011. Meanwhile, Peru now relies more on domestic debt (a great percentage denominated in local currency), which currently represents almost half of the total liabilities of the central government.

The countercyclical role of MDB participation in central government financing is worth noting—an increment of net transfers has coincided with large increments during times of financial stress such as the 1980s debt crisis, the Asian financial crisis, the dot.com bubble burst, and the recent global financial crisis. The three main MDBs in the region (the Development Bank of Latin America [CAF], the Inter-American Development Bank [IDB], and the World Bank)
Net transfers from the International Bank for Reconstruction and Development (IBRD) have been nearly constant with a tendency to become negative, even after the temporal surge during the global financial crisis. Transfers from the IDB have followed a similar pattern, except that the Government of Peru has made important prepayments, such as in 2010, partially financed with global bond issues. In contrast, the CAF portfolio is increasing in Peru, particularly due to new infrastructure loans. Overall, MDBs channel important resources to the central government, but they are no longer the most relevant: domestic financing, bond issuing, and fiscal revenues are now central to public finances.

In summary, the central government structure of finances has changed dramatically during the 1970–2012 period. A look at net transfers gives a comprehensive view of such changes and how Peru has been able to diversify its access to financial sources. Looking at this evolution, it is clear that the capacity to mobilize domestic and external resources has had an impact on the structure of financing of the Government of Peru.

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9 The European Investment Bank, International Fund for Agriculture Development, Nordic Investment Bank, and Organization of the Petroleum Exporting Countries represent less than 1% of these transfers and thus have been excluded.