ISSN 1728-5437

S E R I E S

STUDIES AND PERSPECTIVES

ECLAC OFFICE IN WASHINGTON, D.C.

Financing development in Latin America and the Caribbean

The role and perspectives of multilateral development banks

Raquel Artecona
Marcelo Bisogno
Pablo Fleiss

United Nations

ECLAC

ECLAC
FOR SUSTAINABLE DEVELOPMENT WITH EQUALITY

Thank you for your interest in this ECLAC publication

Please register if you would like to receive information on our editorial products and activities. When you register, you may specify your particular areas of interest and you will gain access to our products in other formats.

Register

UNITED NATIONS

ECLAC

FOR SUSTAINABLE DEVELOPMENT WITH EQUALITY

www.cepal.org/en/publications

facebook.com/publicacionesdelacepal

www.cepal.org/apps

SERIES

19

STUDIES AND PERSPECTIVES

ECLAC OFFICE IN WASHINGTON, D.C.

Financing development in Latin America and the Caribbean

The role and perspectives of multilateral development banks

Raquel Artecona
Marcelo Bisogno
Pablo Fleiss

UNITED NATIONS

ECLAC

This document has been prepared by Raquel Artecona, Economic Affairs Officer in the Office of the Economic Commission for latin America and the Caribbean (ECLAC) in Washington D.C., Marcelo Bisogno and Pablo Fleiss, both of the Inter-American Development Bank (IDB).

The views expressed in this document, which has been reproduced without formal editing, are those of the authors and do not necessarily reflect the views of the Organization.

United Nations publication
ISSN: 1728-5437 (electronic version)
ISSN: 1727-9909 (print version)
LC/TS.2019/32
LC/WAS/TS.2019/1
Distribution: Limited

Printed at United Nations, Santiago
S.19-00213

This publication should be cited as: R. Artecona, M.Bisogno and P. Fleiss, “Financing development in Latin America and the Caribbean: the role and perspectives of multilateral development banks”, *Studies and Perspectives series-ECLAC Office in Washington, D.C.,*No. 19 (LC/TS.2019/32; LC/WAS/TS.2019/1), Santiago, Economic Commission for Latin America and the Caribbean (ECLAC), 2019.

Contents

Abstract

This paper analyses the role that Multilateral Development Banks (MDBs) have played in financing development in Latin America and the Caribbean (LAC) and what their role will be in support of the Sustainable Development Goals (SDGs). In a context where multilateralism is severely questioned, donor countries are moving their resources away from middle-income countries, and MDBs' lending represents a decreasing share of total debt in the region, we show that there is room for MDBs to continue being relevant players.

The economic transformation needed to attain the SDGs in LAC will require a vast mobilization of domestic and external resources to finance the investment required to support the expansion of productive capacities. We argue that despite losing market share in lending, MDBs will continue to play a role of paramount importance in helping the region provided they continue to adapt to the new challenges.

MDBs will have to increase their ratio of mobilization to lending, harmonize their operations with each other, and offer a wide range of solutions for a variety of clients.

Using information from the Development Bank of Latin America, the Inter-American Development Bank, the Central-American Bank for Economic Integration, and the World Bank, we provide a historic perspective on the MBDs flows to the region and their relative importance in financing development.

MDBs will continue prioritizing their bundling operations -combining advisory services, knowledge and financing-. There will be an increasing importance of knowledge generation and private sector lending. While maintaining their role of lenders, MDBs in the region will probably emphasize mobilization over lending and knowledge over financing. Moreover, MDBs will strengthen their anticyclical role, given the shareholder's interest in countering movements in access to global capital markets and mitigating cycles.

While mobilization will become more important, could not substitute adequate capitalization. Ownership of MDBs in LAC will slowly shift towards client countries, while shareholding will continue to matter in determining the speed of expansion of these institutions. Borrowers-majority-owned institutions will rely primarily on capital expansion and continue to gain in market share, non-borrowers-majority-owned institutions will rely on mobilization and client selectivity.

Introduction

The 2030 Agenda for Sustainable Development, the Addis Ababa Action Agenda, the Sendai Framework for Disaster Reduction, and the Paris Climate Agreement outline a new development Agenda. The financing of this Agenda will entail a vast mobilization of public and private resources, domestic as well as external.

Estimating financing needs to achieve the Sustainable Development Goals (SDGs) included in the 2030 Agenda is extremely complex and entails making strong assumptions; estimates tend to fall into a vast range. Nonetheless, all studies agree that the financing needs are challenging. Investment in infrastructure development alone faces financing needs at the global level that amount to US$5– US$7 trillion -6% to 9% of World GDP- per year (UN, 2014). In the case of Latin America and the Caribbean (LAC), estimates of the infrastructure investment gap vary between 5% and 6.2% of regional GDP annually (IDB, 2016).

Public investment will remain central to the achievement of SDGs. Private investment for development will also be needed because of the sheer volume of resources required. They will complement each other in financing the SDGs because of their specificities regarding development orientation, risk tolerance, profit requirements, and cyclicity. Whereas private capital follows risk-reward considerations primarily, public sources have an explicit mandate to contribute to development. Different sources can combine to tolerate different risk levels, with public financing allowing operations in high-risk environments and playing a catalytic role to mobilize private finance.

Domestic resources are the most important source of development finance. In the last two decades, global financial flows for development have increased significantly. The main source of global flows is private flows at market rates: foreign direct investments, bonds, and syndicated bank-lending. Official development finance is also important, especially during financial crises and for the least developed countries. Global flows also include migrant remittances and, to a lesser extent, private grants.

Among global financial flows for development, Multilateral Development Banks (MDBs) historically played a significant role, in particular to finance public and publicly guaranteed (PPG) debt. However, since the turn of the century, private flows have become more available to sovereigns, and MDBs financing has been gradually declining relative to other sources, especially in the largest and richest economies.

We argue that MDBs will continue to play a vital role in financing development and in supporting the SDGs. We focus on the role that MDBs play in financing development in LAC and how they will continue to support the new development agenda. Their funds will fill important financing gaps in infrastructure, social and environmental projects, regional public goods, and integration initiatives. Besides, MDBs are uniquely positioned to help mobilize private capital flows toward developing countries. Their future relevance is guaranteed by the long-term relationship of trust with the borrowing countries, the bundling nature of their operations, their financial competitiveness regarding pricing and maturity, their different risk appetite and the possibility to create markets, and their capacity for leveraging private capital efficiently.

MDBs were created with the purpose of financing development, encouraging economic growth and mitigating poverty in their client-member countries. Their business model allows for their funding in international markets at low costs that are in turn transferred to their clients. Thus, MDBs can provide much-needed financing at favorable financial conditions to clients who do not have easy access to international capital markets. MDBs also provide technical assistance, knowledge generation, and capacity building. In addition, MDBs lend to the private sector and mobilize capital from private investors.

The mandates and instruments of MDBs have evolved along with changing views on development; to accommodate the varying needs of their client countries as economic and financial market conditions changed over time. From an initial focus on infrastructure, these institutions progressively incorporated social issues as well. MDBs supported LAC countries during the debt crisis of the 1980s, and in the 1990s seconded the wave of reforms that took place in the region. In this century, MDBs accompanied the generally positive evolution of LAC economies. Nowadays, SDGs are at the center of MDBs mandates.

We focus on the four major MDBs providing sovereign and non-sovereign guaranteed (SG and NSG) finance to LAC: The World Bank, with its sovereign guaranteed window, the International Bank for Reconstruction and Development (IBRD) and its private sector window, the International Financial Corporation (IFC); the Inter-American Development Bank (IDB), including the IDB-Invest, its private sector window; the Development Bank of Latin America (CAF); and the Central-American Bank for Economic Integration (CABEI). Most of the financing is provided on non-concessional terms: interest rates are set based on the cost of funding plus a spread that allows to cover operative and administrative costs and accumulate capital. Besides, all of them have funds that provide concessional loans, i.e., loans that are extended in terms substantially more generous than market loans.

The four MDBs have a different shareholding composition between borrowing and non-borrowing countries. Non-borrowing countries dominate the voting power of the World Bank. Borrowing countries almost entirely own CAF and CABEI and have a slight majority at the IDB. Ownership structure affects lending allocation, growth, and capital dynamics. Since the global financial crisis of 2008, all the institutions obtained capital increases. However, the frequency, magnitude, and structure of the replenishments varied among MDBs, depending on their shareholding composition. CAF received four (mostly in-cash) replenishments in a short period, almost tripling its equity. The IDB obtained modest increases in their paid-in capital; most of the capital increase was in the form of callable guarantees. The World Bank also received a moderate capital increase in 2010 and approved a new capital replenishment in 2018; the capital package is designed to strengthen the financial capacity of the institution and prioritize lending to countries with per-capita income below US$6,795; very few of which are in LAC. We argue that shareholding composition will continue to determine how MDBs capital is accumulated and used.

MDBs with a significant majority of borrowing countries voting power would rely primarily on capital expansion through periodical replenishments. MDBs with a large non-borrowing shareholding will likely privilege augmenting their capital efficiency through the optimization of their balance sheets. Actions for balance-sheet optimization include merging concessional and non-concessional windows of resources, reducing concentration risk through the exchange of sovereign debt among MDBs, increasing net income through augmenting spreads and reducing transfers, and sharing risk in non-sovereign operations with private investors.

The nature of member demands to MDBs evolved together with the income levels and social progress. Because most countries in LAC have become upper-middle or high-income countries (UMICS and HICS), MDBs will face both demands for more sophisticated products and more competition from other sources of financing, including bonds, private banking, and bilateral lending from emerging powers, mainly China. Profound changes may be needed in the structure of these institutions to provide for the whole spectrum of products demanded by the sovereign and non-sovereign clients and maintain their competitiveness.

Satisfying these increasing demands, most of which are associated with the SDGs, may entail not only institutional changes in the MDBs but expanding their lending capacity. The Agenda calls for using the limited MDBs capital resources as efficiently as possible. Consequently, several voices have been emphasizing the role of mobilization over lending and knowledge generation over financing. Mobilization has been placed at the cornerstone of the Agenda and a critical element to deliver on the SDGs. While acknowledging that mobilization and private sector financing will become more important, we argue that they cannot substitute adequate capitalization and sovereign guaranteed lending.

MDBs still offer a distinct product, they bundle different types of services and facilitate service delivery by the mutual trust earned throughout years of activity with their client base. Moreover, they are adept at crowding in private finance for development by assisting governments in creating market-oriented growth and co-participating in specific private sector investments. Until now, institutions have managed to expand their lending capacity and have found the demand to utilize this extended capacity fully. We foresee that multilateral flows to LAC will continue to expand.

The expansion of lending in the region will not be uniform across MDBs. Regional Multilateral Development Banks (RMDB) will grow faster. The World Bank has expressed an interest in focusing on the poorest countries and move away from its higher-income clients. Therefore, it is reasonable to expect that its lending to LAC (which became a region of mostly UMICS and HICS), will decrease in relative terms. Beyond the increasing importance of RMDBs, it is possible that new MDBs will start servicing the region. Thus, coordination among MDBs may become more complex due to the larger number of MDBs and the more fragmented ownership structure.

In summary, there is strong evidence that MDBs will remain relevant partners in development. They are uniquely placed to address global and regional challenges at every stage of the economic cycle. They also fulfill an important catalytic role in crowding-in private finance for development. Their work on climate change, gender equality, and improvement of institutional capacity would make a significant contribution to the 2030 Agenda. However, the future importance of the MDBs will depend on their successful adaptation to the new circumstances.

The paper continues as follows. Section I briefly describes the MDBs creation and financial model. Section II analyzes the evolution of mandates of MDBs across decades. Section III focuses on the description of the major MDBs in LAC. Section IV presents a perspective of MDBs outstanding, commitments and disbursements to the region in the past 25 years. Based on these recent trends, section V discusses the role and outlook of MDBs in financing development in the region.

I. Multilateral development banks: origins and financial model

The creation and expansion of Multilateral Development Banks (MDBs) can be understood as the answer of the international community to the challenges posed by critical situations of different magnitudes at different points in time. For example, the World Bank was created in 1945 to finance the reconstruction of Europe and Japan in the immediate post-second world war and to promote economic growth in developing countries. Once the Marshall Plan took over the post-war reconstruction, the World Bank focused on assisting poorer countries, including those of LAC. In the words of Gurría & Volcker (2001): “With private capital flows restricted as well as financially risky, many countries were unable to attract foreign private capital to finance socially productive investments. The solution was to create an institution backed by the capital commitments of the United States and other capital-rich nations that could borrow at the lowest market rates and lend economically to those with urgent needs, first nations ravaged by war and later those in the early stages of economic development.”

A quarter century later, in the context of the cold war, the Alliance for Progress (a program aimed to establish economic cooperation between the U.S. and Latin America), concluded that a region-specific institution was needed to advance development in the region. The Organization of American States (OAS) drafted the Articles of Agreement establishing the Inter-American Development Bank, replicating the organization of the World Bank at a regional level. The first RMDB was born.

Following the creation of the IDB in 1959, several sub-regional development banks were formed in LAC in the 1960s: The Central American Bank for Economic Integration (CABEI) in 1960, the Andean Development Corporation (CAF, now Development Bank of Latin America) in 1968, and the Caribbean Development Bank (CDB) in 1969. At the time of their creation, none of these institutions compared in size to the IDB. In the 1990s, CAF extended its membership to new members of Latin America expanding its capital and lending capacity significantly.

Since then, following a global trend of MDBs proliferation (see Kellerman 2018), new development banks have continued to be created. The Plata Basin Financial Development Fund (FONPLATA) was established in 1974 to service the southern cone of South America. More recently, other MDBs have been created and offered to service the Latin America and Caribbean region. They are the New Development

Bank (NDB, also known as the BRICS Development Bank), established by Brazil, Russia, India, China, and South Africa, and the Asia Infrastructure Investment Bank (AIIB) created to serve the Asia-Pacific region, but with the possibility of lending to members beyond Asia if the project delivers a clear benefit to that region. Nowadays, seven LAC countries are prospective members of the AIIB.

The capital base of all MDBs includes the paid-in and callable contributions of their members and retained earnings. Paid-in capital represents the cash contributions made by members during successive replenishments of capital. Callable capital is a guarantee given by the member countries that backs MDBs bond issues. The callable portion of the capital stock subscriptions is subject to call only when required and to the extent necessary to meet the obligations of the MDB on borrowings of funds or guarantees. To date, no MDB has ever had to draw on its callable capital. Retained earnings are the net income (i.e., income from loans and investments net of borrowing expenses, non-reimbursable services provided to clients, and administrative costs) that is retained and added to the capital as accumulated reserves. MDBs retain the full amount of their net income. This practice reinforces MDBs' balance sheets significantly. Accumulated reserves are the main source of capital accumulation of these institutions, representing approximately 60-65% of the balance sheet of the World Bank and the IDB.

Both borrowing and non-borrowing member countries subsidize MDBs capital. For example, shareholders do not receive dividends for their capital investments (net income is fully retained) nor do they charge any fees for the callable capital used as guarantee. Borrowing members also make a distinctive contribution to MDBs by granting the so-called Prefer Creditor Status (PCS) --an arrangement that gives priority to the MDBs in the repayment of borrowing countries' obligations by allowing a senior claim to their reserves or primary government surpluses, following the Paris Club principles.

The complex arrangement behind the institutional architecture of MDBs entails a mechanism for allocating these subsidies (Buiter & Fries, 2002). For example, subsidies flow from non-borrowing to borrowing members because both contribute to capital but only the latter receive financing. Moreover, the existence of economies of scale in the preparation of projects generates a subsidy from large to small borrowers. In addition, since individual sovereign risk is a significant factor affecting the cost of capital but are not a consideration when setting MDBs loan charges, less risky countries cross-subsidize riskier countries implicitly.

The basic financial model of MDBs is to leverage the capital resources through the issuance of debt, to provide loans on more favorable (relative to international financial markets) conditions. MDBs use their capital to leverage it through the issuance of highly rated bonds and other debt securities they sell in the international financial markets. These securities are purchased mainly by institutional investors such as pension funds, commercial banks, insurance companies, and corporations around the world, and by governments. The funds obtained are used to finance borrowing countries under financial terms more favorable than what would be available to them under market conditions. In this way, countries in need of investments can use savings accumulated throughout the world.

MDBs access international financial markets in more favorable financial terms than individual borrowing members, due to the subsidized capital base, the PCS, the guarantees, and the natural diversification of their portfolios among countries, i.e., risk pooling. In turn, they transfer these conditions to their clients in the form of loans with long maturities and grace periods and below-market interest rates. The favorable terms of the loans remain a primary determinant of the demand for MDBs finance and the core function of these institutions.

Most of the MDBs lend to the public and private sector. Pricing to the private sector is set to avoid crowding-out of private financing. Most of the sovereign guaranteed financing is considered non-concessional; loan charges are based on actual funding cost to the institutions plus a spread that allows the funding of operations. For example, a typical loan could be granted at a LIBOR rate (3 or 6 months) plus a spread that goes from 50 basis points (bps) to 250 bps, depending on the institution and the maturity of the loan. Non-concessional loans are provided with a maturity of 15-30 years and a grace period of 5 years. In addition, most of the institutions also have a "soft" window that supports lending to low-income countries at a subsidized rate, below market conditions. For example, 0.25% of interest rate, and a "bullet" repayment at 40 years.

Beyond financing, MDBs also offer a set of non-financial services including knowledge generation and dissemination. Borrowing countries receive technical assistance and capacity building provided by MDBs. These organizations also facilitate the provision of regional public goods, including their support to the integration processes. For donors, the multilateral nature of the MDBs entrenches a comparative advantage in allocating finance for development by helping mitigate the risk of investing in developing countries by themselves (see Rodrik 1995). Also, being part of an institution allows their companies to bid in the procurement of projects.

Lending, in the case of MDBs, comes bundled together with know-how and valuable experience gained by MDBs in similar projects in other countries and it is often assisted by technical cooperation. While many of these components could be separately purchased in the market by the client countries, in the case of the MDBs they come all packed together. A cohesive element in this package is the trust earned by MDBs in their relationship of many years with their clients/partners-in-development.

While the role of MDBs goes beyond funding programs, the financing component remains central. When financial markets were thin, MDBs were particularly instrumental in channeling funds to developing countries. For the smaller and less developed countries, MDBs could at times be the major (if not the only) source of international financing. Many developing countries do not have regular or permanent access to international capital markets and definitively, not under the financial terms that these highly rated institutions could offer.

Finally, while international government borrowing from private sector lenders is procyclical, borrowing from MDBs is countercyclical (Galindo & Panizza 2018). This countercyclicality is explained for demand and supply side considerations. Besides filling financial gaps during economic slowdowns when private capital markets are tighter, being countercyclical is part of the MDBs mandates. In the next section, we will further discuss these mandates and their historical evolution.

II. The evolution of mandates of the multilateral development banks

MDBs views on development have evolved over time and with them, their macroeconomic recommendations and sectoral focus. After switching from post war reconstruction to development, the World Bank focus remained in infrastructure. The institution prioritized infrastructure projects in developing countries with emphasis on transportation and energy projects. The focus on infrastructure for development was in line with Harrod-Domar, Rosenstein-Rodan, and Hirschman growth and development theories of the 1950s and 1960s that considered public infrastructure fundamental for development.

By the early 1960s, at the time of the creation of the IDB, development views had started to recognize human capital as a necessary complement to physical capital for economic development. The initial focus of the IDB was on sectors other than those prioritized by the World Bank at that time; broadening the scope of the new institution beyond infrastructure to include social sectors. The creation of the IDB was, in part, to provide funding to the social sector (Garcia, 2015): education, water and sanitation, healthcare and rural development. New RMDBs also placed an important emphasis on integration.

Over time, the World Bank started to cover all these sectors as well, diversifying its original infrastructure specialization. While the World Bank and the IDB now share a broader sectoral diversification, including environment and social projects, LAC RMDBs (other than the IDB) tend to concentrate on infrastructure. The system of RMDBs and the World Bank has, at times, interacted to coordinate service delivery; although, most of the times, coordination among MDBs has been low.

The Debt Crisis in the 1980s dramatically changed the development priorities in the region, triggering a new set of development problems. These new challenges resulted in new demands to the MDBs and strategic and operational responses from them. Before the crisis, international private lending to LAC had been reestablished in the 1970s within a context of highly liquid international financial markets. The crises exposed the risks of sovereign borrowing from private lenders in a context of high liquidity and the lack of preparedness of many developing countries to confront a situation of easy access to financing.

Commercial bank loans were granted in a context of low real interest rates and strong international demand for the region's exports and high prices for those products. Once this situation reversed, with export demand and export prices declining and a steep increase in real interest rates, most countries in the region encountered problems in servicing their debts. Mexico was the first to stop repaying its debt in 1982, and other countries followed suit. The Debt Crisis of the 1980s revealed that sovereign borrowing from private banks exposed the region to a type of risk that was significantly different from that of borrowing from MDBs and other official public sources. Private financing, if unrestrained, could make developing economies more volatile, further deepening their economic cycles.

Against the backdrop of this financial crises, a structural reform process was undertaken in most countries in the region during the 1980s and early 1990s. The predominant view at the time, what came to be known as the Washington Consensus, was that developing countries needed to open their economies, reduce the scope of government intervention and adopt prudent macro and monetary policies. The rationale was that reducing the state involvement in the economy would release the potential of free markets and allow for a more efficient allocation of resources. In this context, both the World Bank and the IDB promoted the privatization of state-owned enterprises in many areas and addressed the scaling down and modernization of the states. Infrastructure projects received little support from these institutions as these policy reforms were expected to attract private sector investment to that area.

To assist countries confronting debt and balance of payment imbalances, MDBs developed a new set of tools that went beyond investment projects. MDBs designed the "Policy Loans": an instrument for which money flowed to the treasuries of the countries in exchange for policy and institutional reforms that were thought to address the structural causes of the imbalances. The policy reforms were induced through the conditionality attached to each policy loan disbursement. Policy loans would provide additional fast funding to heavily indebted countries in need of fresh funds.

Inducing structural reform through policy conditionality required close coordination of the main international financial institutions to guarantee their implementation. Consequently, the roles of the International Monetary Fund (IMF), the World Bank and the IDB were coordinated to deliver on the implementation of those policy recommendations. CAF, an institution almost exclusively capitalized and managed by LAC countries, remained active in sovereign lending for public infrastructure gaining market share vis-à-vis the World Bank and the IDB. By maintaining its focus on infrastructure, by 2010, CAF was lending more to public infrastructure projects in LAC than the World Bank and IDB together (Perry and Garcia, 2017).

By the late 1990s, the achievements of the reforms promoted by the Washington Consensus were deemed to have come short of expectations. Following this decline, MDBs adopted a more complete and complex view of development during the second half of the 1990s and the beginning of the twenty-first century. Efforts to substitute public sector financing and provision in social areas were reevaluated, reassessing the role played by public sector institutions in achieving growth and development (Burki and Perry, 1998). This vision was anchored in Douglas North's "New Institutional Economics." The operational counterpart of this change resulted in projects aimed at improving the efficiency and effectiveness of the public sector, focusing on the quality of public sector institutions in service delivery rather than on the reduction of the size of the public sector.

Departing from Washington Consensus, MDBs revised conditionality. By early 2000s most countries in the region had managed to reduce fiscal deficits, cut inflation rates to the single digits and reduce their debt to GDP ratios. The twenty-first century also brought about new demands for social inclusion in the region that, together with the increased access to international financing enjoyed by most countries in Latin America, resulted in changes in MDBs operations. Interventions in poverty alleviation were strengthened, policy conditionality was reviewed, and policy ownership by governments was revalued. Environmental concerns continued to evolve while MDBs developed internal structures to address these issues as well as expanded involvement with civil society in their defense of environmental and social safeguards. Non-governmental organizations (NGOs) became particularly attentive to big infrastructure projects; exerting pressure on MDBs to review and modernize the way infrastructure projects were carried out on social and environmental grounds.

Policy loans, as a mechanism of budget support, continued to be appreciated and demanded by client countries; but the conditionality included in those loans changed. Multi-tranches policy-based loans with strong conditionality as a precondition for disbursement of each tranche were gradually abandoned and substituted by single tranche operations and programmatic policy loans. In the single tranche policy loan, most (or all) of the conditions were met before the board approvals of these loans. Programmatic policy loans were developed to adopt a more flexible view of conditionality. Unlike the old multi-tranche policy loans with fixed conditionality stated at the time of approval, the programmatic policy loans allowed for conditions to be reviewed and reevaluated over time to adapt to the changing reality in the field. The ensuing process became a dialogue between the MDB and the borrower rather than an imposition; thus, respecting the ownership of the policy reform agenda by borrowing governments.

Beyond sovereign guaranteed lending, MDBs have always provided NSG loans. In 1956 the World Bank Group launched the IFC "to further economic development by encouraging the growth of productive private enterprise in member countries, particularly in the less developed areas, thus supplementing the activities of the IBRD" (IFC, 2017). Recognizing the importance of private sector development, the IDB always allowed the possibility of lending without SG. Moreover, since its creation CAF has financed projects that mainly involved small business (García 2015). CABEI has also provided financing to the private sector since its origins, especially in competitiveness services.

The relevance of private sector lending has significantly increased since the 1990s. Policy changes worldwide placed a greater dependence on the private sector to promote development. Consequently, substantial financing for the private sector and further development of capital markets is required to substitute public investment, particularly in infrastructure. Growing demand for better coordination between the public and the private sector emerged, with the rise of NSG lending.

Nowadays, private sector lending and mobilization have been placed at the center of the strategy to achieve the SDGs. For example, the "cascade approach" of the World Bank (see World Bank, 2017) states that projects should be financed with public funding only if there is no sustainable private sector solution. Furthermore, according to this approach policy regulatory gaps or weaknesses that hinder private financing shall be addressed before pursuing public funding. Another example of the importance that mobilization has in the new development agenda is the expansion of the use of so-called "blended finance," defined as "the strategic use of development finance for the mobilization of additional finance towards sustainable development in developing countries" (OECD, 2018). Consequently, MDBs has set ambitious targets on mobilization and private financing for the next years.

Finally, the new development agenda has imposed a refocus of the mandates of the MDBs toward greater collaboration between MDBs and the United Nations (UN) to achieving first the Millennium Development Goals (MDGs) and later the SDGs. As a result, MDBs new mandates pay special attention to sustainability, social and environmental safeguards, climate change, and gender equality related projects. Nowadays, a substantial percentage of operations in MDBs is aligned with SDGs. In parallel, there has been a growing focus on providing "value for money"; a concept that includes making better use of MDBs balance sheets, mobilizing greater amounts of private finance, and improving the coordination and collaboration among institutions.

III. Major multilateral development banks financing Latin America and the Caribbean

The World Bank, the IDB, CAF, and CABEI account for more than 95% of the MDBs lending to LAC. The four MDBs finance SG and NSG projects. The first two are more complex organizations, with several sub-institutions and funds, each having its own membership, governing boards, and articles of agreement. At the World Bank, SG lending is provided by the International Bank for Reconstruction and Development (IBRD) while the International Finance Corporation (IFC) lends without sovereign guarantee. At the IDB, since 2016, the Ordinary Capital (ORC) provides SG lending, and the IDB Invest (previously the Interamerican Investment Corporation) approves NSG lending. CAF and CABEI are simpler institutions each with a single balance sheet for SG and NSG lending.

Most MDB lending is non-concessional. In addition, these institutions provide concessional lending (i.e., lending at extraordinary long tenures with interest rates well below market-levels), pure grants, and non-reimbursable technical cooperation through a variety of funds. Most of these funds are financed either with transfers from net income or through donor contributions. At the World Bank, the main source of concessional lending is the International Development Agency (IDA). At the IDB, concessional lending was historically provided by the Fund for the Special Operations (FSO) and the Grant Facility (GRF). CAF and CABEI also have a series of funds that provide non-reimbursable technical cooperation and are financed by net income.

Table 1 presents some basic information about the CAF, CABEI, the ordinary capital of the IDB and the IBRD. The four institutions are significantly different in size. The administrative expenses of the IBRD are about 15 times those of CAF and 45 times those of CABEI respectively. Being a world-wide institution, IBRD's client diversification allows it to have equity-to-loan ratios (at 22%) significantly below those of the RMDBs (36% for the IDB -including the transfers from the FSO-, 46% for CAF and 41% for CABEI).

Of note, the ratio of disbursements to approvals has been significantly lower in CAF than in the other three institutions. This may be explained by CAF's concentration in infrastructure (with slower disbursements) and financial credit lines, which not necessarily are disbursed once approved. For example, in 2017 CAF approved US$6.1 billion in SG and NSG credit lines, over a total of $12.6 billion (48.6%).

In terms of total outstanding, the IDB and the IBRD still are the two main sources of multilateral debt to the region.

Table 1
MDBs basic information, 2017
(In millions of dollars)

	IBRD	IDB (Ordinary Capital)	CAF	CABEI
2017				
Outstanding Loan Balance	57,325	84,572	24,061	6,835
Assets	405,898	126,240	38,112	9,721
Equity	39,798	32,247	11,122	2,831
Administrative Expenses	2,145	736	150	46
2013-2017				
Total Approvals	28,495	60,152	59,707	8,857
Total Disbursements	25,817	49,550	38,130	7,496
Variation in Outstanding	8,790	13,893	5,829	1,439

Source: Compiled by authors based on Information Statements of IBRD, ORC, CABEI, and CAF. Data on IBRD is based on Fiscal Years. Outstanding Loan Balance, approvals and disbursements of IBRD correspond only to LAC region, while Assets, Equity, and Adm. Expenses are Bank-Wide. Outstanding Loan Balance of IDB in 2017 does not include the transfer of concessional loans from the FSO for $4,510 million.

Regarding governance and capital structure, the four institutions have different shareholding composition between borrowing and non-borrowing countries. While non-borrowing countries dominate the voting power of the IBRD, CAF and CABEI are almost entirely owned by borrowing members.[1] The IDB is slightly majority owned by borrowing countries, although the biggest shareholder is the U.S which enjoys veto power on major policy decisions that depend on the Board of Governors; the latter is also true for the IBRD. Differences in shareholding have a bearing on pricing and lending volumes (see for example Humphrey & Michaelowa, 2013 and Humphrey, 2014). We argue that shareholding composition affects the pattern of capital accumulation, including the magnitude and frequency of capital replenishments.

During the 2008 global financial crisis, to stabilize world growth, the G20 "agreed to increase very substantially the resources available through the international financial institutions and to ensure that the institutions have the facilities needed to address the crisis in a coordinated and comprehensive manner" (G20, 2009). Accordingly, MDBs dramatically increased their lending beyond sustainable levels, running out of resources. The majority of MDBs subsequently obtained capital increases. The composition of the replenishment varied across institutions though.

The IBRD obtained in 2010 its first capital increase in twenty years; the replenishment involved a global increase of US$86.2 billion (31% of the capital base at that time), of which US$5.1 billion (6%) corresponded to paid-in capital, equivalent to approximately 12% of total equity. Following the replenishment, a significant increase in lending volumes and substantial transfers to IDA (that decreased the reserves and accumulated earnings), offset the increase in paid-in. Consequently, the World Bank

1 Spain and Portugal, non-regional members of CAF, have received loans from this institution. Public and commercial banks own a small part of the shareholding. Argentina, Colombia, Republic of China (Taiwan), and Spain are non-borrowing members of CABEI.

Group negotiated a new capital increase in 2018 to strengthen its financial capacity. The package includes the implementation of a comprehensive financial framework to ensure that IBRD's lending remains sustainable over time.

The IDB also obtained a capital increase in 2010; the previous replenishment was approved in 1994. The ratios of paid-in to callable capital were lower than those of the World Bank. At the IDB, the US$70 billion increase in the callable capital (equivalent to 70% of the existing capital base) included a paid-in capital of only 2% (less than 10% of total equity). The low paid-in together with the compromise of transferring US$2 billion to Haiti embedded in the replenishment agreement and the later increase in the sovereign risk of one of its major clients altogether affected the financial outlook of the institution by 2015. As a result, the IDB implemented a series of measures to revamp its capital base.[2]

Between 2007 and 2015 CAF had four consecutive replenishments totaling US$10.8 billion; as a result, the authorized capital tripled to US$15 billion. Most of this increase was in the form of paid-in capital. This enabled a rise in lending that generated a significant increase in accumulated reserves. In 2009, CABEI shareholders agreed to boost authorized capital from US$2 to US$5 billion more than duplicating its paid-in. In 2018, CABEI obtained an increase to its authorized capital from US$5 to US$7 billion. Both institutions have experienced an upgrade of their ratings in the last decade.

Table 2 summarizes. CAF and CABEI obtained the highest level of capitalization among the four MDBs. The replenishment in these two institutions relied heavily on paid-in while at the IDB and the World Bank the authorized capital increased mainly via an expansion of callable.[3] The increase in callable, while functional for non-borrowing members as it saved them to contribute with in-cash resources, was not as relevant an option for borrower-dominated MDBs as the guarantees of borrowing members are less valued than those of the non-borrowers.

These significant capital increases permitted borrower-owned institutions to expand their lending at a higher rate, allowing them to accumulate more earnings, and, in the case of CAF, outplace the IBRD as the second source of sovereign financing for the region. The IBRD did not receive enough fresh funds to expand their lending at a sustainable pace and transfer resources to non-concessional sources simultaneously; a further capital increase was necessary to compensate for the imbalances. At the IDB, where shareholding is shared practically equally between borrowers and non-borrowers, the initial capital increase was also insufficient. After assessing the lack of appetite for a new replenishment, the institution took measures to optimize its balance sheet according to the guidelines expressed by the G20.

[2] First, it raised loan charges. At the IDB, where new charges apply to both new and old loans, this measure result in a rapid increase in net income and consequently in capital accumulation. Second, it merged the FSO with the ORC. As the FSO was a fund with limited liabilities, the transfer of assets to the ORC translated in an increase in equity. Third, it implemented an exposure exchange agreement (EEA) to swap portfolio risk with other MDBs. The EEA is a framework agreement between MDBs for an exchange of sovereign exposures. It allows MDBs to manage their capital concentration risks through reducing exposure in countries where lending volumes and capital requirements to support lending were high and creating exposure in non-member countries.

[3] Besides these four institutions, other regional banks received substantial capital increases during the period. The Caribbean Development Bank (CDB) approved in 2010 a capital increase of $1 billion (22% paid-in component); the largest expansion of resources in the Bank's history. The Financial Fund for the Development of the River Plate Basin (FONPLATA) experienced a major process of institutional reform and tow capital increases. The first in 2013 was for $1.15 billion ($350 million in paid-in) and the second in 2016 for $1.375 billion ($550 million in paid-in).

Table 2
Voting power and capital structure by MDB
(In percentages and million of dollars)

IBRD	IDB (Ordinary Capital)	CAF	CABEI
Voting Power 2017:	Voting Power 2017:	Voting Power 2017:	Voting Power 2017:
Borrowers[1]-38.08%	Borrowers – 50.02%	Borrowers[2]-100.00%	Borrowers[3]-83.73%
Non-Borrowers-61.92%	Non-Borrowers-49.98%	Non-Borrowers-0.0%	NonBorrowers-16.27%

	2007	2017	2007	2007	2007	2017	2007	2017
Paid-In Capital	11,486	16,109	4,340	6,039	2,249	8,244	420	1046
Reserves and Accumulated Earnings	28,440	23,689	16,013	20,396	1,878	2,878	1,215	1,784
Additional Paid-In[4]				5,812				
Equity	**39,926**	**39,798**	**20,353**	**32,247**	**4,127**	**11,122**	**1,635**	**2,831**
Callable Capital	178,315	252,828	96,613	164,901	1,112	1,590	1,303	3,287
Unpaid Subscribed Capital					30	1,413	277	49
Rating S&P	AAA	AAA	AAA	AAA	A+	AA-	A-	A

Source: Compiled by authors based on Information Statements of IBRD, ORC, CABEI, and CAF.
[1] Include all borrowers of IBRD, IDA, and Blend (144 countries).
[2] The voting power of the borrowers includes Spain, Portugal, and Public and Private Commercial Banks of the Region.
[3] Beneficiary Countries. Includes Mexico, who receive $150 million in 2016.
[4] By Additional Paid-In the IDB accounts for the transfer of all FSO's assets and liabilities effective January 1, 2017. Without the transfer from FSO, IDB capital would have increased by 30% (instead of 58%).

IV. Multilateral Development Banks flows to the Region: a Historical Perspective

This section shows key trends regarding multilateral debt stock and flows to Latin America over the last 25 years. The first part focuses on the debt stocks and flows at an aggregate level. Then, the analysis focuses on the debt stock and flows disaggregated by MDB, considering the four primary sources of multilateral financing to the region.

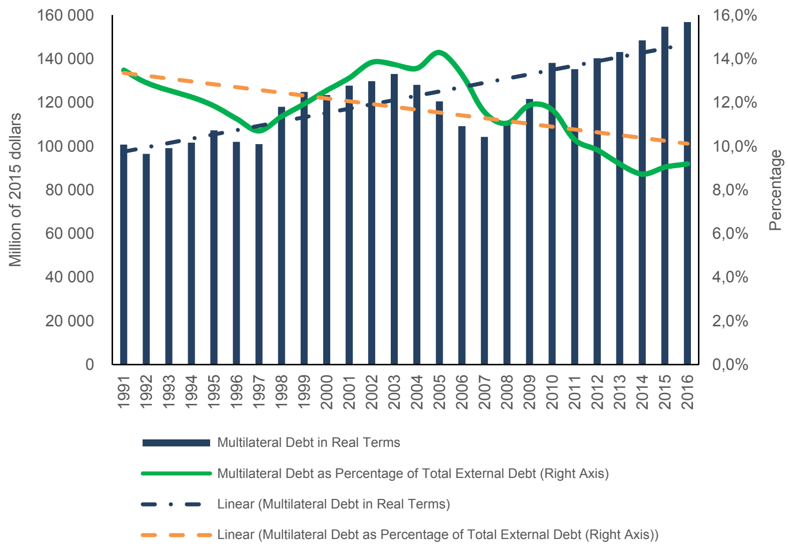
Four main features characterize the evolution of aggregate multilateral debt to LAC in the past 25 years. First, the stock of multilateral debt has grown in real terms. Second, this growth has not been linear over time; rather, there have been growth spurts during years of crises. Third, multilateral debt has declined relative to private debt. Fourth, this decline in the share of MDBs relative to private financing to sovereigns varies with the size of the country, with larger economies bearing higher relative exposure to private funding. For small countries, MDBs financing remains crucial even when private financing is available.

Figure 1 shows MDBs debt stocks to the region by year, in real terms. All nominal values have been deflated by the U.S. inflation (base 2015=100). Multilateral debt has grown at a yearly rate of approximately 1.8%. This growth has not been constant over time. After a stalemate in the early 1990s, following the 1998-99 Asian crisis debt stock increased significantly until 2003. Since then, debt stocks declined until 2007. The global financial crisis produced a new surge in multilateral debt stocks.

The crisis at the end of the 1990s triggered a rise in disbursements that dissipated by the beginning of the twenty-first century. By mid-2000s, favorable market conditions contributed not only to reduce the demand for new funds but also prompted the prepayment of much of the debt incurred in the previous crisis; thus, negative net flows and a corresponding reduction in debt stocks were observed in 2004-2006. The global financial crisis reverted this trend, leading to a further increase in net flows and debt, particularly in the following two years. Since the crisis was global, there was a consensus among the international community that MDBs should support their borrowing member countries to avoid sudden stops that could impact the economic accomplishments of the first decade of the century. Net flows remained at a relatively high level, as capital increases enhanced the supply capacity of the various multilateral institutions that received fresh funds during the period.

Figure 1 also shows that although multilateral debt stocks grew in real terms, they declined as a percentage of total external debt due to a faster expansion of private debt (debt acquired by private debtors as well as public debt financed by private creditors), especially in the last ten years. In parallel, multilateral debt has also decreased as a percentage of national income. During the whole period of analysis, the region grew faster than multilateral debt, implying that multilateral financing is becoming smaller in relation to the regional economy.

Figure 1
Multilateral debt stocks in real terms and as a percentage of total external debt
(In million of 2015 dollars and as a percentage of Total External Debt)



Source: International Debt Statistics, The World Bank and US Bureau of Labor Statistics.

Multilateral debt decreased not only as a percentage of total external debt but also as a percentage of public and publicly guaranteed debt (PPG). Table 3 shows the composition of PPG between official (multilateral and bilateral) and private (bonds and commercial banks) debt.

In the early 1990s, the Brady Plan converted commercial bank debts to sovereigns into bonds, following the defaults of the 1980s. The prevalence of bonds over loans remains until today; however, the share of private bank's loans recovered during 2010-2016. Improvements in macroeconomic conditions and low-interest rates led to a resurgence of commercial bank lending to the public sector.

On the official side, the re-focusing of the international donor community away from middle- income countries and towards fighting extreme poverty in Africa, led to a continuous decrease in the share of bilateral debt throughout the period. The bilateral debt in LAC was almost halved in the 1990s in real terms. From that level, it was again halved in the last 15 years.

However, data on bilateral debt deserves to be handled with caution. Because China is not part of the Development Assistance Committee (DAC) group of donors who report data in a standard manner, International Debt Statistics data may underestimate China's support to the region. New databases from the Inter-American Dialogue (Gallagher and Myers, 2017) and AidData (Dreher et al., 2017) look at the recent flows of bilateral lending from China.

According to these datasets, a new form of bilateralism is emerging. China financing to the region has reached approximately US$150 billion in commitments in the last ten years (2008-2017). Financing has been provided mainly through the China Development Bank (CDB) and China Export-Import Bank. This represents about 60% of all MDBs SG lending in the same period. Around 90% of this financing is concentrated in four countries: Argentina, Brazil, Ecuador, and Venezuela. In these countries, as well as in Bolivia and Costa Rica, bilateral lending from China surpassed that of MDBs.

Multilateral debt continuously increased its share in PPG debt until 2010, and then sharply decreased in the last five years. In the aftermath of the last global crisis, international financial markets have opened for small countries and expanded in big ones. The reduction in interest rates has led to an increase in capital flows to the region, both in the form of bonds and commercial loans. Finally, the table shows the differences in the importance of official financing among countries in the region. For the seven largest economies, the share of official creditors has decreased from 1/3 to 1/5 of the total PPG debt. Although the share of official creditors for smaller countries also declined, it still accounts for more than half of total public debt. Aggregated data underestimate the importance of multilateral flows in small countries. In fact, in non-LAC7 countries, more than 50% of total PPG debt is official.

Table 3
Public and publicly guaranteed debt in Latin America by type of creditor
(As a percentage of total PPG)

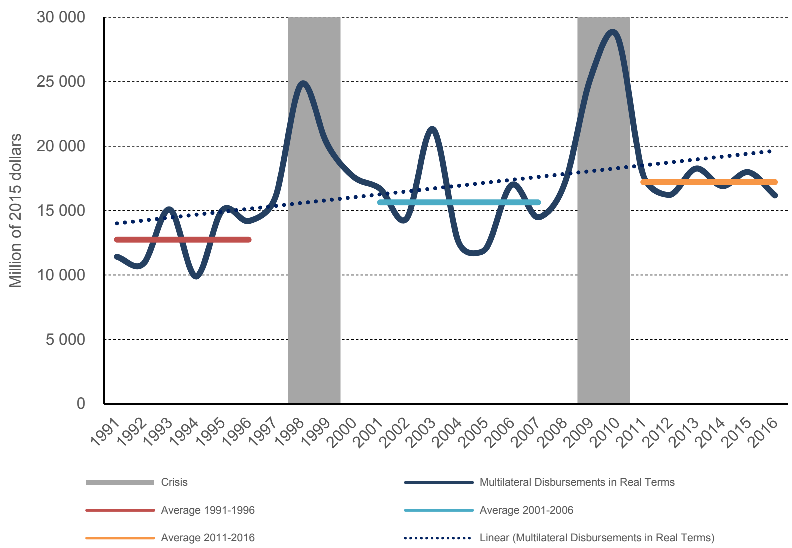
	1991	2000	2005	2010	2016
Bonds	24.3%	55.9%	58.3%	56.0%	57.5%
Banks + Other Private	36.3%	9.2%	9.8%	8.8%	16.6%
Sub-total Private Creditors	**60.6%**	**65.1%**	**68.0%**	**64.8%**	**74.2%**
Bilateral	20.9%	11.8%	7.5%	8.2%	5.8%
Multilateral	18.5%	23.1%	24.5%	27.0%	20.1%
Sub-total Official Creditors	**39.4%**	**34.9%**	**32.0%**	**35.2%**	**25.8%**
LAC 7: Official Creditors	33.4%	29.6%	27.1%	30.2%	20.9%
Rest of LAC: Official Creditors	71.1%	66.4%	58.1%	65.7%	52.7%
Real Public and Publicly Guaranteed Debt (100%)	**544,132**	**535,465**	**492,762**	**511,449**	**781,538**

Source: International Debt Statistics, The World Bank and US Bureau of Labor Statistics. Total PPG is expressed in millions of US$ in 2015. LAC7 includes Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela.

MDBs disbursements in real terms have shown a positive trend, albeit highly cyclical, in the last 25 years. Figure 2 shows real multilateral disbursement to LAC. Disbursements increased significantly in periods of crisis, especially in 1998-1999 and 2009-2010. Following each crisis, multilateral disbursements moderated, although average post-crises disbursements remained above pre-crisis levels.

The capital increases obtained in the aftermath of the crisis allowed MDBs to increase their sustainable lending levels, which in turn, expanded their lending envelopes. By sustainable lending level, we refer to the approval volume that allows an MDB to maximize its operativity without jeopardizing its finances and requesting further capital replenishment. MDBs, particularly RMDBs, managed to lend their expanded capacities despite the greater access of their clients to the international financial markets.

Figure 2
Multilateral Disbursement to Latin America in real terms
(In millions of 2015 dollars)



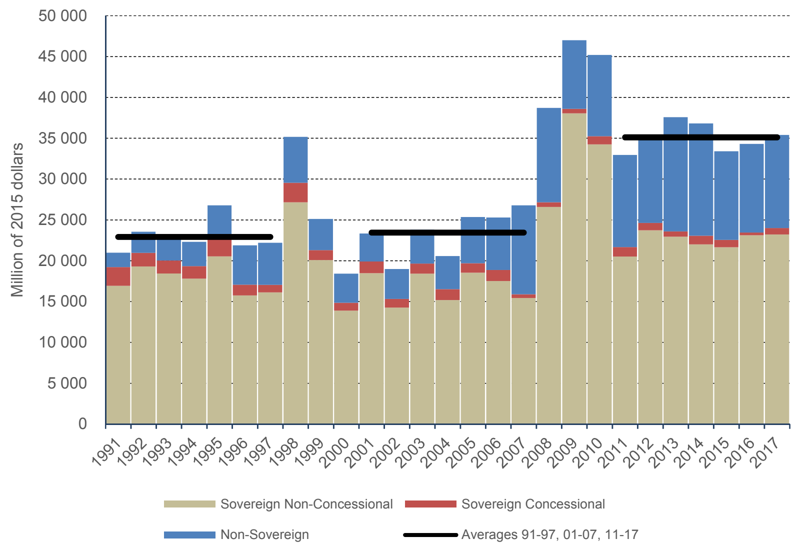
Source: International Debt Statistics, The World Bank and US Bureau of Labor Statistics.

Figure 3 shows the commitments of the four major MDBs in the region. Commitments have grown in real terms peeking during the 1998-1999 and 2009-2010 crises. Average post-2009 commitments are significantly higher than commitments before the crises.

Regarding the composition, on average, 70% of the total commitments correspond to non- concessional sovereign guaranteed loans, 27% are non-sovereign guaranteed loans and only 3% concessional loans and grants. Concessional lending to the region is not only small in absolute and relative terms, but also decreased over time. This is consistent with the fact that the region has moved (over the last 25 years) from a region of low- and middle-income to middle- and high-income countries. For example, out of 26 borrowing member countries of the IDB, in 2004 15 were low- or lower-middle-income countries and 11 were upper-middle- or high-income countries. In 2015, only six countries were LICs or LMICs, and 20 were UMICs (15) or HICs (5). Consequently, fewer countries have access now to concessional funding. It is foreseeable that concessional lending will be further reduced.

There is an increase in the role of the private sector, especially since the end of the global financial crisis, although NSG approvals are highly procyclical. Besides the natural pro-cyclicality of private enterprises' demand, MDBs where one balance sheet finances SG and NSG loans have a natural tendency for public financing to crowd-out private funding in years of crises. The private sector reform of the IDB Group and the strong capitalization of the IFC points at a further increase in the share of NSG lending.

Figure 3
Total Approvals CABEI+CAF+IDB+WB in real terms
(In million of 2015 dollars)

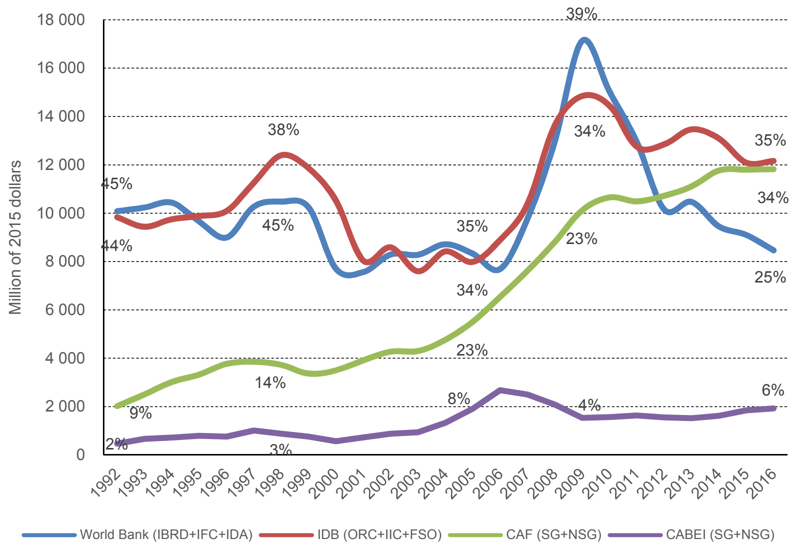


Source: Compiled by authors based on data from multilateral development banks and US Bureau of Labor Statistics. Data from IFC (part of the non-sovereign) is expressed in fiscal years.

Figure 4 shows individual trends by multilateral institutions in real terms. A 3-year moving average is computed to moderate annual fluctuations. The World Bank used to be the largest financial institution in Latin America and the Caribbean, with 40% of total approvals in the early 1990´s; now represents only 25% of total approvals. CAF shows the opposite trend, going from 20% to almost 40% over the same period. Both the continuous growth of CAF and the slow-down in World Bank lending (except during the last crisis) generated a change in the relative importance of each institution in total regional financing. Today, the market share of CAF is close to IDB's. CABEI increased its relative importance moderately.

Approvals from the World Bank have remained constant during the whole period, except during 2008-2010, where approvals reached historical maximums. Latin America is the region that receives more non-concessional resources from the IBRD. During the global financial crisis, the World Bank increased their lending to all the regions. However, after the crisis, lending to LAC plummeted at pre-crisis levels, as the institution focused on other, poorer regions. It is likely that the World Bank will continue this trend. CAF, on the other hand, experienced a sharp increase in approvals, without clear evidence of cyclicality. In real terms, CAF's average approvals for the three years 2015-2017 tripled the average for 2000-2002. The IDB shows an in-between behavior. It exhibits a more moderate cyclical pattern than the World Bank, especially in the aftermath of the last crisis, where a higher level of annual lending (made possible by the bank's capitalization), were put in place.

Figure 4
Approvals by Multilateral Development Bank in real terms, 3-year moving averages, 1992-2016
(In million of 2015 dollars)



Source: Compiled by authors based on data from multilateral development banks and US Bureau of Labor Statistics. Percentages refer to the participation of each MDB in total approvals in the selected years.

Table 4 compares the bond issuances with MDB commitments in the region. It reaffirms that the behavior of large countries explains the predominance of bonds over MDBs at the aggregate level. In small countries, MDBs commitments still exceed debt issues in amount. The table shows the great procyclicality of bonds. After the crisis there was a significant expansion of bond issuance throughout the region; the market of bonds multiplied by two in bigger countries and by four in smaller ones. Overall, bonds doubled after the crisis; the sharpest increase in relative terms was in the smallest economies, where they tripled. MDBs commitments declined particularly in larger economies.

Table 4
Bond Issuances and MDBs Commitments to the Public Sector, 5-year total, 2012-2016
(In thousands of dollars)

Group of Countries	2007-2011		2012-2016	
	Bonds	Commitments	Bonds	Commitments
LAC 7	68,937	85,494	123,453	67,803
Rest of LAC	11,304	35,403	44,782	45,080
Total	**80,241**	**120,898**	**168,235**	**112,883**

Source: Compiled by authors based on ECLAC and annual yearbooks of IBRD, ORC, CABEI, and CAF.
LAC7 includes Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Venezuela.

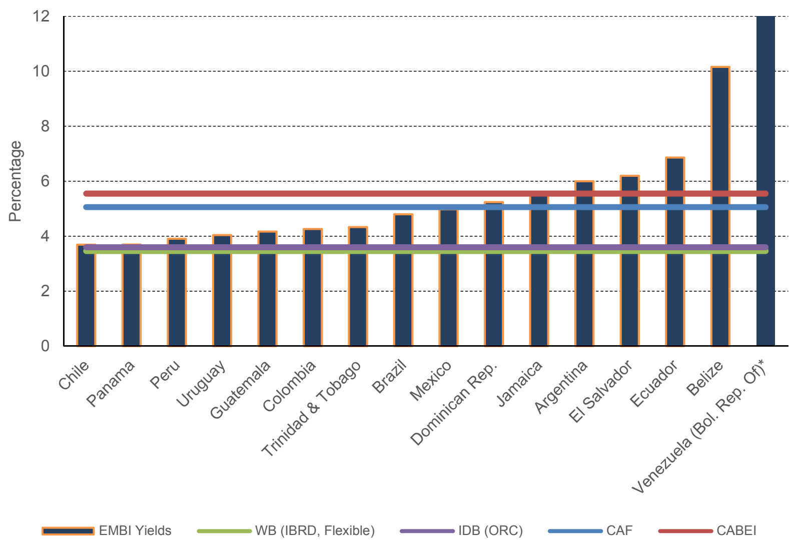
The competitiveness of MDBs is an important issue regarding the future of multilateral financing. The growth of bonds over that period is explained not only by the exceptional access to international markets that countries enjoyed but also to the lower financing costs relative to the prices charged by MDBs.

Figure 5 compares the sovereign EMBI yields of Latin-American countries with the all-in rate equivalents of the four MDBs.[4]

AAA MDBs (The World Bank and the IDB) pricing is nowadays equated to the bonds of the highest-rated LAC countries. The recently approved financing framework for IBRD is likely to put its prices above market rates for high-income countries with investment-grade status. This could lead to priced-out these countries (a movement equivalent to de-facto graduation). While graduation discussions can take years to reach the needed consensus between the institution and the borrowing member, the lack of MDBs price competitiveness could make these countries subject to graduation to demand less multilateral financing voluntarily. While the World Bank has a long history of graduation, regional banks so far have avoided these kinds of discussions. The natural concentration of regional banks stresses the need of having every country as a borrower; particularly those with less relative risk.

CAF is more expensive than half of the countries in the region. For countries such as Colombia and Peru with good ratings, most of the lending from CAF is without sovereign guarantee. On the other hand, countries such as Ecuador and Venezuela demand more intensively loans with sovereign guarantee. While CABEI is the most expensive of the four institutions, it still offers better financial conditions that international financial markets for most of its borrowing member countries, especially Nicaragua and Honduras who have limited access to international markets.

Figure 5
Sovereign yields and MDBs All-In Rate Equivalents, December 2017
(In percentage)



Source: Compiled by authors based on data of ECLAC (2018) and Finance Department of the IDB, WB, CAF, and CABEI.
*Venezuela (Bol. Rep. of) is bounded at 12% to facilitate the visual comparison.

[4] The all-in rate is constructed as the sum of the lending spread, plus the commitment and front-end fee in terms of spread, the 10-year swap for 3-month LIBOR (a swap differential between 6-month and 3-month LIBOR has been added to lenders that have 5-month LIBOR as their base rate), and the respective funding margins. For the World Bank, the considered lending rate is the variable spread with a weighted average life of 12-15 years, so there is a maturity premium (but not a market risk premium).

V. Looking forward

At a time when multilateralism is severely questioned, donor countries are moving their resources away from UMICS and HICS, and MDBs' lending represents a decreasing share of total debt in the region, we argue that there is room for MDBs to continue being relevant players in the development of the Latin America and Caribbean region.

The economic transformation needed to attain the SDGs in Latin America and the Caribbean will require a vast mobilization of domestic and external resources to finance the long-term investment required to support the expansion of productive capacities. We argue that MDBs will continue to play a role of paramount importance in helping the region provided they continue to adapt to the new challenges.

MDBs will have to respond to the increasingly complex demands of their clients by diversifying their options for local currency operations and expanding financial products and complementary services. They will also have to make a more efficient use of their balance sheets by increasing their ratio of mobilization to lending, harmonizing their operations with each other, and keeping all clients on board, irrespective of their size, risk, and income level. To play this role, MDBs will have to remain adequately capitalized to expand lending and assume higher risks.

Regarding the future of MDBs in LAC we foresee the following trends:

Multilateral flows to LAC will continue to expand due to the enhanced lending capacity of the existing MDB institutions and, to a lesser extent, to the increase in the number of MDBs servicing the region. RMDBs will play a greater role in the expansion of lending to the region as the World Bank prioritizes supporting the poorest countries and moves away from higher income clients. This will result in borrowing/developing members having a greater say in the determination of the MDB's development agenda in LAC.

The lending capacity of existing institutions will grow through net income accumulation and sparse capital increases. We expect that net income accumulation will increasingly play a more critical role than capital increases. Paid-in contributions by non-borrowing members will be less available as non-borrowing countries prioritize other regions.

This expansion notwithstanding, MDBs flows to LAC will continue to decrease in relative size vis-à-vis private lenders. Although the stock of multilateral debt grew in real terms in the region, it declined as a percentage of total external debt due to a faster expansion of private lenders, especially in the last ten years. The region has enjoyed broader access to capital markets since the beginning of the twenty-first century with many countries placing medium term bonds at relatively low costs for the first time in their modern history. However, bond financing continues to be deeper for the biggest and most developed LAC countries.

Sovereign demand for MDBs financing will become more anti-cyclical. As private financing to sovereigns in LAC grows in significance, the region will become more exposed to procyclical financing. As said, private financing, both bonds and commercial banks, tend to cut back during busts. To compensate, sovereign demand to MDBs will likely increase during troughs compelling MDBs to expand their anticyclical role. This will be especially true for RMDBs which will have to step up their anticyclical role.

For this, MDBs will have to overcome the procyclical nature of the capital adequacy models used by rating agencies. They may have to develop the discipline to reserve capital during expansions for anticyclical purposes to increase their leverage during busts and raise charges to increase lending during the low part of the cycle. In this regard, the recent package for the of the capital increase of the World Bank specifically discusses the construction of "a substantial financial buffer that would allow IBRD financing to scale up rapidly in response to crises" (World Bank, 2018). It is to be expected that a significant part of the World Bank activity in the region will concentrate on countercyclical operations.

MDBs will face increasing pressure to remain competitive. We foresee that MDBs price and maturity competitiveness relative to private capital will continue to narrow despite cyclical fluctuations. The presence of China as a new source of financing in the region furthers this pressure. Less efficient MDBs would risk losing their highest rated clients. For RMDBs, with fewer clients than the World Bank, losing some of their clients would further concentrate their portfolios on the lowest rated clients, diminishing the average rating of their portfolios and reducing the benefits of the risk pooling mechanism. Thus, to remain competitive RMDBs will seek to keep the entirety of their sovereign clients.

Economies of scale, risk diversification, and cooperative considerations will all combine to make graduation or income-based price discrimination not an option for RMDBs. The World Bank has a graduation policy that converts borrowing countries into non-borrowing (donors) based on the income and the access to international financial markets of the country. In addition, since 2018, the IBRD has raised charges for HICs. Without ruling out graduation, this new price policy would tend to price out some of IBRD's prime HICs clients. Unlike graduation, the income-based price discrimination scheme would leave the door open for HICs to borrow if needed; likely, at the time of cyclical downturns. With fewer sovereign clients and some of the biggest clients at the near top of the income list, graduating by income would compromise economies of scale.

MDBs non-sovereign guaranteed lending will grow faster than their sovereign counterpart. We foresee that lending to the private sector will continue to gain share vis-a-vis sovereign lending. First, private-sector oriented institutions have recently received a more generous capital replenishment than the sovereign ones.[5] Second, in the new development agenda there are strong preferences for funding private-sector solutions when possible (see for example, the "cascade approach"). Third, improvement in credit ratings among regional countries could also result in a boost in private lending as usually highly-rated countries reduce their demand for SG lending relative to NSG.

The relative expansion of NSG lending would require improved coordination between public and private sector windows. The focus on reforms and risk-sharing schemes from the public sector for better deploying private sector solutions together with the preference for PPP financing alternatives reinforce the need for stronger coordination. MDBs have already launched several initiatives to improve harmonization between the public and private sector.

[5] In the World Bank, the proposed capitalization defined a paid-in contribution of $5.5 billion for the IFC and $7.5 billion for the IBRD, when the equity is $26 billion for the former and $42 billion for the latter. The IDB significantly capitalized and reformed the IIC (BID-Invest) in 2015 while the last replenishment of the Ordinary Capital was in 2010. Moreover, IIC capitalization includes transfers from the Ordinary Capital.

MDBs' will enhance their developmental impact per dollar lent through mobilization. MDBs can play a substantial role in mobilizing private financing; identifying and de-risking projects and making them bankable. Because their historical links with governments and the private sector, MDBs have a unique comparative advantage in serving as intermediaries between country developmental needs and private finance. Consequently, MDBs have set ambitious goals to increase mobilization.

Notwithstanding mobilization, lending to member countries at competitive terms would remain the main function of MDBs in the region. Implementing market solutions for development may not be feasible for all countries and all sectors. Therefore, public resources will continue to be used as the only possible option in many cases.

Coordination among MDBs may become more complex due to the larger number of MDBs, financing mechanisms and instruments, and the more fragmented ownership structure. With overlapping functions and mandates, MDBs proliferation and the fragmentation of ownership will reinforce coordination problems. Ownership fragmentation is based on the fastest growth of borrower-based institutions and the entrance of new MDBs with ownership outside DAC. The available sources of funding for development have broadened; coordinating the diverse range of actors, mechanisms and instruments and incorporating them into a coherent development financing architecture becomes very complex. The multiplicity of existing financial options does not amount to effective access and the capabilities of each country to access the difference sources of financing varies greatly. (ECLAC, 2018).

Countries' demand will be intensive in knowledge, bundling services and new, more sophisticated instruments. As LAC countries move up the income ladder, their needs will become more specific and complex, requiring much more than just access to finance. Member countries will need the technical assistance and convening power of MDBs in areas of complex knowledge and financial issues (Development Committee, 2015). Knowledge will remain a key component of MDBs services and bundling (when financial, analytical and technical support is combined in one product), will continue to be highly valued by borrowers.

VI. Conclusion

MDBs are distinctively placed to address global and regional challenges. They are uniquely equipped to handle climate change mandates and other regional and global public goods. They can help countries improve the institutional capacity of the governments to formulate and implement better public policies. They will be key in setting the conditions that would attract private capital to the provision and operation of public infrastructure.

To accomplish all this, MDBs will have to remain well capitalized as they will have to co-lend and co-invest with the private sector, as well as work on the development of the private sector conditions. Historically, MDBs in LAC managed to lend their expanded credit capacity. This is because they have been able to offer more competitive credit conditions than the international financial markets and created new financial products and complementary services catering to the changing needs of their clientele. The latter needs to be maintained and expanded to secure the future of MDBs in the region.

Bibliography

Buiter, Willem and Steven Fries (2002), "What Should the Multilateral Development Banks Do?" *Working Paper*, No. 74, European Bank for Reconstruction and Development.

Dreher, Axel, Andreas Fuchs, Bradley Parks, Austin Strange, and Michael Tierney (2017), "Aid, China, and Growth: Evidence from a New Global Development Finance Dataset", *AidData Working Paper* #46

ECLAC (Economic Commission for Latin America and the Caribbean) (2017), "Financing the 2030 Agenda for Sustainable Development in Latin America and the Caribbean: The challenges of resource mobilization", Santiago de Chile, ECLAC.

______ (2018), "The challenges facing Latin America and the Caribbean regarding financing for the 2030 Agenda for Sustainable Development", Santiago de Chile, ECLAC.

______ (2018) "Emerging Markets Bond Index Monitors", Washington Office, based on data from JPMorgan Chase.

G20 (2009), "Declaration on Delivering Resources through the International Financial Institutions", G20 Leaders' Conclusions on Development, London Summit.

Galindo, Arturo and Ugo Panizza (2017) "The Cyclicality of International Public Sector Borrowing in Developing Countries: Does the Lender Matter?", *IDB Working Papers*, No 8559.

Gallagher, Kevin and Margaret Myers (2017) "China-Latin America Finance Database," Washington, DC, Inter-American Dialogue.

García, Enrique (2015), "Comparative Advantages and Challenges of Regional Development Banks: the CAF experience", *Policy Brief*, No. 2.

Gurria, José Angel and Paul Volcker (2001) 'The Role of the Multilateral Development Banks in Emerging Market Economies: New Policies for a Changing Global Environment", Report of the Commission of the role of the MDBs in Emerging Market Economies.

Humphrey, Chris (2014), "The Politics of Loan Pricing in Multilateral Development Banks", *Review of International Political Economy*, Vol. 21, No. 3, February.

Humphrey, Chris and Katharina Michaelowa (2013), "Shopping for Development: Multilateral Lending, Shareholder Composition and Borrower Preferences", *World Development*, Vol. 44, No. 4.

International Finance Corporation (2017), "IFC The First Six Decades. A History". Washington, DC, IFC.

Kellerman, Miles (2018), "The Proliferation of Multilateral Development Banks", *The Review of International Organizations,* forthcoming.

Perry, Guillermo and Eduardo García (2017), "The Influence of Multilateral Development Institutions on Latin American Development Strategies", *Alternative Pathways to Sustainable Development: Lessons from Latin America*, G. Carbonnier et al. (eds.), Brill-Nijhoff.

Ocampo, José Antonio (2006), "Regional Financial Cooperation: Experiences and Challenges", Regional Financial Cooperation, J.A. Ocampo (ed.), Washington, D.C., United Nations Economic Commission for Latin America and the Caribbean, Brookings Institution Press.

Rodrik, Danny (1995), "Why Is There Multilateral Lending?", *NBER Working Paper*, No. 5160.

UN (United Nations) (2014), "Report of the Intergovernmental Committee of Experts on Sustainable Development Financing", New York, United Nations.

UNCTAD (United Nations Conference on Trade and Development) (2017), "The Role of Development Banks in Promoting Growth and Sustainable Development in the South. Economic Cooperation and Integration among Developing Countries", Geneva and New York, United Nations.

World Bank (2017), "Maximizing Finance for Development: Leveraging the Private Sector for Growth and Sustainable Development", Washington, DC, Development Committee.

World Bank (2018), "Sustainable Financing for Sustainable Development", Washington, DC, Development Committee.

Annex

Table A.1
Commitments by type. All institutions
(In millions of dollars)

	World Bank*				Interamerican Development Bank				Development Bank of Latin America			Central American Bank of Economic Integration			Total
	Sovereign Guaranteed		Non-Sovereign Guaranteed	Total	Sovereign Guaranteed		Non-Sovereign Guaranteed	Total	Sovereign Guaranteed	Non-Sovereign Guaranteed	Total	Sovereign Guaranteed	Non-Sovereign Guaranteed		
Year	Non-Concessional	Concessional			Non-Concessional	Concessional									
1991	5,067	170	502	5,739	4,532	908	102	5,542	437	418	855	159	11	170	12,305
1992	5,257	405	607	6,269	5,188	804	158	6,150	506	732	1,238	222	50	272	13,929
1993	5,852	317	710	6,879	5,295	598	124	6,016	834	729	1,562	308	95	402	14,859
1994	4,435	312	815	5,562	4,551	671	44	5,265	1,028	820	1,848	367	200	566	13,241
1995	5,715	345	1,048	7,108	5,991	1,083	182	7,255	1,319	1,019	2,339	117	276	393	17,095
1996	4,047	390	1,257	5,695	5,890	640	275	6,805	864	1,450	2,314	338	244	582	15,395
1997	4,438	125	1,188	5,751	5,071	553	471	6,095	1,213	1,687	2,900	381	168	550	15,295
1998	5,680	360	1,057	7,097	8,479	928	780	10,187	968	1,705	2,673	595	351	945	20,902
1999	7,133	604	807	8,543	8,256	567	813	9,636	1,269	912	2,181	161	176	336	20,697
2000	4,148	165	1,038	5,351	4,289	449	655	5,393	1,517	806	2,323	208	119	328	13,396
2001	5,207	530	705	6,442	6,857	708	401	7,965	1,841	1,356	3,197	483	101	585	18,189
2002	4,211	178	1,144	5,533	3,606	631	437	4,675	2,385	905	3,290	408	319	727	14,225
2003	5,918	153	1,262	7,332	5,684	792	528	7,004	2,166	1,137	3,303	399	304	703	18,343
2004	4,981	338	1,218	6,537	4,806	756	623	6,185	2,330	1,172	3,503	525	240	764	16,990
2005	4,904	262	1,398	6,564	5,900	565	673	7,138	2,473	2,273	4,746	1,410	368	1,778	20,227
2006	5,654	256	1,747	7,658	4,472	966	1,120	6,558	3,791	1,730	5,521	1,361	889	2,251	21,987
2007	4,456	200	1,781	6,437	6,524	202	2,523	9,248	2,984	3,622	6,607	1,142	1,752	2,894	25,186
2008	4,353	307	2,943	7,603	8,964	188	2,419	11,570	3,343	4,603	7,946	1,114	311	1,426	28,545
2009	13,829	202	2,721	16,752	14,301	350	1,297	15,948	5,590	3,580	9,171	1,174	83	1,258	43,128
2010	13,667	240	3,006	16,913	11,297	548	1,177	13,022	5,796	4,737	10,533	1,209	294	1,503	41,971
2011	9,169	460	3,031	12,660	8,939	422	1,925	11,286	4,528	5,538	10,066	1,364	265	1,630	35,642
2012	6,181	448	3,680	10,309	9,538	566	1,890	11,993	4,586	4,689	9,275	1,398	122	1,520	33,097
2013	4,769	435	4,822	10,026	11,283	439	2,423	14,145	5,453	6,423	11,876	1,245	123	1,368	37,415
2014	4,609	460	4,057	9,125	10,257	514	2,821	13,592	5,052	6,570	11,622	1,391	211	1,601	35,941
2015	5,709	315	2,379	8,403	8,463	472	2,287	11,222	5,616	5,921	11,537	1,577	279	1,857	33,019
2016	8,035	183	2,688	10,906	9,088	267	2,237	11,592	6,497	5,916	12,412	1,857	248	2,106	37,016
2017	5,373	504	2,693	8,569	10,899	388	3,199	14,486	6,436	5,823	12,259	1,766	160	1,926	37,241

Source: Compiled by authors based on data of CABEI, CAF, IDB, and WB.

Data on World Bank is expressed in Fiscal Years.

UNITED NATIONS

ECLAC Studies and Perspectives – Washington, D.C.

Issues published

A complete list as well as pdf files are available at

www.eclac.org/publicaciones

19. Financing development in Latin America and the Caribbean: the role and perspectives of multilateral development banks, Raquel Artecona, Marcelo Bisogno, Pablo Fleiss, LC/TS.2019/32, LC/WAS.TS2019/1, 2019.
18. Sovereign credit ratings in Latin America and the Caribbean: trends and impact on debt spreads, Inés Bustillo, Daniel Perrotti and Helvia Velloso, LC/TS.2018/107, LC/WAS/TS.2018/6, 2018.
17. Labour issues in the digital economy, Raquel Artecona and Terence Chau, LC/WAS/TS.2017/3, 2017.
16. Ensuring Incentives for Innovation and Access to Medicines, Raquel Artecona and Rosine M Plank-Brumback, LC/WAS/L.143, 2017.
15. Energías y políticas públicas en Estados Unidos: una relación virtuosa para el desarrollo de fuentes no convencionales, Inés Bustillo, Raquel Artecona, Isabel Makhoul, y Daniel E. Perrotti, LC/L.4093, LC/WAS/L.137, 2015.
14. Puerto Rico: economic headwinds and fiscal challenges, Inés Bustillo and Helvia Velloso, LC/L.4078, LC/WAS/L.136, 2015.
13. Global financial rulemaking and small economies, Raquel Artecona and Inés Bustillo, LC/L.4048, LC/WAS/L.134, 2015.
12. Organic food market in the United States: Market access opportunities for Latin American and Caribbean producers, Anne-Christine Scherer, LC/L.3696, LC/WAS/L.125, 2013.
11. Estimating the effects of U.S. food safety and agricultural health standards on agro-food exports from Latin America and the Caribbean, Raquel Artecona and Robert Grundke, LC/L.3255-P, LC/WAS/L.112, Sales number: E.10.II.G.60, 2010.
10. Cambio y Oportunidad: la responsabilidad social corporativa como fuente de competitividad en pequeñas y medianas empresas en América Latina y el Caribe, María Emilia Correa, Bernhardus Van Hoof y Georgina Núñez, Coordinadora, LC/L.3197-P, LC/WAS/L.110, Sales number: S.10.II.G.9 (US$ 10), 2010.

19

STUDIES AND PERSPECTIVES

ECLAC

Series

ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN

COMISIÓN ECONÓMICA PARA AMÉRICA LATINA Y EL CARIBE

www.eclac.org