

ALIDE TURNS 40: CHALLENGES AND PROSPECTS FOR LATIN AMERICAN AND CARIBBEAN DEVELOPMENT BANKS

ALIDE President, Dr. Nicola Angelucci, in making the keynote address during the celebration of the 40th Anniversary of the Latin American Association of Development Financing Institutions (ALIDE) on January 24, 2008, noted that a group of 37 banks and development financing and promotion institutions from 16 of the region's countries had attended a conference especially convened and held on that date in 1968 at the headquarters of the Inter-American Development Bank in Washington, D.C., where they signed ALIDE's Articles of Incorporation. Today, ALIDE has a membership numbering 78 banks from 24 countries in the region and Europe and international and regional multilateral financing organizations.

DEVELOPMENT BANK CHALLENGES

As we well know and recognize, the basic guidelines of the economic policies applied in the region today are well-defined: there is widespread agreement on giving the market a key role to play, accompanied by the State's intelligent participation; and the increase in productivity through investment, technology and education; macroeconomic stability; and competitive participation in the international economy are all perceived as being key elements for development.



Dr. Nicolla Angelluci, at that time President of ALIDE, delivering the keynote presentation at the celebration of the Latin American Association's 40th birthday.

At the level of Latin American development financing --as ALIDE has pointed out on numerous occasions-- freeing and regulating financial markets is not enough to make them competitive. They require explicit development financing policies that acknowledge the importance of development banks as appropriately designed instruments operating in response to policies of financial innovation and

complementarity to bring about a change in our economic production structures and support the production sectors. Among these are micro, small and medium enterprises whose adaptability and flexibility are characteristics needed by global markets and whose contribution to creating jobs is so necessary in our countries.

Development banks have oriented their action toward filling the gaps in the market by developing markets and financial and non-financial instruments, complementing the efforts of local banks, maximizing the local coverage and penetration of the market, optimizing services and implementing development financing policies determined autonomously by the countries. All of this to be done with a medium and long-term vocation, recognizing that exclusive models do not exist, that continuous benchmarking and appropriate identification of the financing needs of enterprises and families are needed, and that they should do their work in compliance with the principles of financial sustainability and organizational efficiency.

Given the variety of situations and realities that exist in Latin America today, development banks face extremely diverse challenges that are not homogenous and that differ from country to country. It should be emphasized that there is no exclusive development banking model, for its operational configuration depends upon each country's individual nature and environment.

With this vision, the development banking system faces a variety of challenges in order to finance the production and social sectors, technological innovation, education, the environment, infrastructure, economic integration, and so forth.

At the same time, a significant advance has been made toward recognizing the importance of development banks and the role they can play in supporting growth and economic development in a region where, as a rule, financial markets are shallow and little developed. In addition, they face heterogeneous production systems, making the demand for credits from the financial market also very heterogeneous. This heterogeneity calls for a wide variety of instruments to supply those credits, which imposes the **first important challenge** on development banks: that of developing financial instruments that will make it possible to manage the risk and heterogeneity of the different production agents.

In the particular case of our countries, which have a tendency to experience sudden interruptions in their credit flows, GDP level and national income are directly affected. Credit in Latin America is synonymous with banks and capital markets are not yet important as loan intermediaries. However, the specificity of the banking system puts it in a very procyclical situation. This characteristic is almost generalized among financial systems that depend upon banks, which have a stronger procyclical nature than do systems where capital markets are more important. This does not mean there is a market failure, but a structural situation. In this sense, a **second challenge** facing development banks, in addition to doing what commercial banks fail to do, is to play a countercyclical role.

A **third challenge** is to produce more competitive economies that add value and create new sources of wealth --in other words, to increase investment, produce innovations and impede the continued widening of gaps between our countries and

developed countries in regard to innovation and knowledge. There is also the challenge of creating institutions that will be capable of leading our economies in this connection.

Development banks have serious problems in facing demands for financing because normally they have certain prototypes for economic agents and because of the wide diversity among these, it is difficult to assess the risk, thus making financing more expensive. This is another area where development banks face challenges because promoting access to financing does not mean simply delivering credit, but also moving toward the possibility of providing financial services to the different economic agents through instruments that will permit appropriate risk management.

A **fourth challenge** is to clearly identify the needs of the entrepreneurial sector continuously, inasmuch as economic changes create new needs and under those circumstances development banks need to offer a variety of products complementary to traditional credit, such as guarantees, insurance, factoring, information, entrepreneurial education and training, etc. Furthermore, it is not only a matter of supplying production infrastructure, but also of improving the competitive structure of the enterprises themselves. It should be recognized that behind access to credit lie far more serious problems, such as, for example, the fact that small entrepreneurs frequently lack business training, and that it is necessary to provide support in this connection.

A **fifth challenge** is to achieve a balance between doing something that is important, on the one hand, and something that is sustainable, on the other. In the past, development banks began to do things --sometimes with a large measure of populism and other times with too much willfulness-- that they were unable to sustain. To play their role adequately, development financing institutions need to achieve a balanced design that will make it possible to conciliate their development efforts with the preservation of their economic and financial soundness. This is probably the basic point that should be considered in analyzing the function of development banks in the globalized world and in the context of open financial systems. It is a known fact that a financial system that manages risks with market criteria and that is also subject to strict supervision aimed at risk minimization has a bias against the more "expensive" agents and those with a greater relative risk. It is precisely these segments which development banks target and they must avoid the risk, in seeking to correct this market failure, of showing a bias in the opposite sense, for this would conspire against their future viability.

There is evidence that an effort is underway in several of the region's development financing institutions, backed by the necessary political will of the respective governments, to harmonize the promotional and development function assigned to them, but with financial self-sufficiency, inasmuch as they cannot count on State financial assistance to build up or replenish their capital or for expanding their loan capacity. For that reason, they must find their natural source of funds in the market and an answer to their capital needs in their profitability.

When one refers to the subject of public policy and development financing institutions, one must necessarily refer to the tension that exists and which in some way affects the behavior or situation of development banks. I am referring to the tension that exists between the political will that is expressed on different fronts with respect to "what is to be done with these institutions and their resources?" and, on the other hand,

the challenge to maintain the sustainability and efficiency of development financing institutions. This refers to the fact that many of the pressures that are brought to bear stem from short-term interests or political interests regarding the use of these institutions for purposes that in reality they are unable to properly fulfill and that create serious problems for their sustainability. Consequently a **sixth challenge** is to strengthen the notion and practice that development banks should belong to the sphere of public policy, which is long term, rather than that of government policy, which is short term. The problems development banks experienced in the past and are experiencing today have to do precisely with the absence of long-term public policy in our countries.

This leads to another challenge, for as public institutions, they must create mechanisms for sustainability, transparency and the rendering of very clear accounts. They must be extraordinarily transparent to be able to be part of a public policy. They must also make it possible for an element that is no less important, which has to do with the stability of the professional and technical staff and with internal learning processes. This learning requires stability over time, for otherwise there would be a risk of having everything that has been learned vanish when changes are overly frequent. This leads us, then, to a **seventh challenge**, which is to have good corporate governance. The objectives and requirements are much broader for development banks than for private commercial banks because they also include: a) guaranteeing long-term solvency in order to minimize fiscal and taxpayer costs (shareholder last); b) clearly defining the institution's mission and ensuring its fulfillment (avoiding action outside their mandate); c) avoiding political interference; d) eliminating conflicts of interest with stakeholders; and e) guaranteeing a separation between the work of public policy formulation and state ownership.

In the context of the pursuit of equity as a development policy objective, an **eighth challenge**, of key importance for the promotion of economic and social development by development banks is the construction of inclusive financial systems, the strengthening of financial democracy and the creation of opportunities for the masses. The traditional approach has been to try to increase the supply of services and financial resources by mobilizing national and international savings, new credit instruments and long-term financing, specialized institutions, and improvements in efficiency and governance. Little attention has been given to the other side of the problem: that of the demand for credit. All of the financial engineering developed thus far is for large enterprises. For that reason, inclusive financial systems need institutions to develop credit recipients, which constitutes a very broad field for development banking action.

The importance of infrastructure as a key factor for economic growth is widely accepted. The evidence is clear that larger investments in infrastructure improve economic growth rates, mainly because they favor long-term growth and help reduce poverty and inequality. Furthermore, in countries like ours, where the provinces are frequently disjointed and economic activity is concentrated in the capital city, infrastructure would make it possible for distant areas to play a part in the national and international markets and improve the competitiveness of national production. As a result, boosting the development of productive and social infrastructure constitutes a **ninth challenge** for development banking, for our region suffers from a great deficit.

The rapid changes that have been noted in the global economy have given shape to a new scenario with new and important actors on the world scene and with a series of integration alternatives and systems, not only within regions, but also between them. Important markets have opened up for Latin America and the Caribbean, both as destinations for their exports and sources of investment that will make it possible for more market and product diversification, while at the same time reducing their external vulnerability. In order to take advantage of these opportunities, however, explicit policies of entrepreneurial support are needed within the framework of integration and/or cooperation systems. This constitutes an important and **tenth challenge** for development banks --that of supplying enterprises with the tools and financial resources they need to reinforce their capacities and take advantage of the opportunities offered by those new export markets.

DEVELOPMENT BANKING PROSPECTS

Insofar as the prospects of development banking are concerned, its field of action for the coming years is, to our way of thinking, twofold. First, it should stimulate financial development by introducing instruments to increase the availability of medium and long-term resources and second, it should apply operational policies designed to support the branches of activity that can contribute most heavily to economic growth and boost entrepreneurial and technological development, particularly that of micro, small and medium enterprises (MSME). In that connection, the efficiency of development banks will depend upon and be subject to the fulfillment of both their social or institutional and entrepreneurial functions.

The institutional efficiency of development banks is tied in with aspects like their capacity to provide access to credit to sectors with a high economic and social priority that are not served by commercial banks; the influence they can exert on the creation of new enterprises, the promotion of new investments and the creation of jobs; their contribution toward promoting innovation and technological adaptation; their promotion of entrepreneurial development; and their credit complementary services, etc. The operational or entrepreneurial efficiency of development banks is expressed through their compliance with banking standards similar to those of any private financial intermediary, with appropriate levels of bank profitability and solvency. Maintaining a sound situation is now, more than ever, essential for fulfilling their mission.

Well-managed development banks are an effective instrument for guaranteeing enterprise access to financing, as well as for generating an adequate supply of long-term credit and promoting financial innovations aimed at strengthening domestic financial development.

Looking towards the future, it can be stated that the role development banks will be called upon to play will be defined by the challenges the economies must meet, which can be summarized as follows: 1) the need to attain stable and sustained growth rates in order to create the well-paid jobs the population demands and above all to overcome the problem of extreme poverty; 2) reaching higher levels of productivity and competitiveness; and 3) attaining balanced regional development that respects the environment and greater integration of production chains, particularly those relating to export activities. The development banking system should be capable of offering

specific products to cover the needs at each stage of entrepreneurial development, from the project's conception, through investment and growth, to the possibility of its restructuring.

At the same time, it should be stressed that one of the problems Latin American development banks faced in the past was their attempt to solve all problems. They can handle some instruments, but not all. The contribution they are capable of making is important, but not unlimited. For that reason, the efforts of development banks in the future should be framed within a broader strategy that would include regulatory aspects and the supply of non-entrepreneurial development services. We should think of development banks not only from the viewpoint of their limited niche, but of the development challenge in which they represent and are an integral part of the solution, but not the only variable.

There must be a correspondence between their characteristics and action insofar as their environment and development policy are concerned. Therefore, in speaking about a development financing system, the development banking system should play the role for which it was designed, but the integration of development banks and commercial banks, capital markets and financial agents and agents of civil society is necessary. This means having a greater vocation in the future for exchanging experiences and designing and carrying out joint and coordinated activities among banks to take advantage of the benefits of integrated efforts.

Furthermore, the great challenges created by globalization make it not only necessary, but essential, to strengthen development banking in our region. An efficient and transparent development banking system oriented toward creating financial market segments that do not develop automatically, can not only play an essential role in the globalized world, but also become a powerful driving force for private financial development. Over the past three or four decades, the countries that grew most rapidly, particularly in Southeast Asia, took advantage of globalization for export-driven growth. A key element of their strategy was that they construed globalization in their own terms, not on the basis of external economic dictates. All of these countries have strong development banks, governments that play significant roles and a far more pragmatic than ideological view of the balance between the government and the private sector. I believe we are moving in that direction with the existence of a far more favorable environment that recognizes the need for and important role played by development banks in boosting the formation of more inclusive financial markets.

Within the framework of regional integration and to take advantage of the possibilities offered by financial and entrepreneurial cooperation, development banks may, among other things: a) identify business and investment opportunities; b) participate in financing the preinvestment needs of binational and multinational initiatives; c) support technological development, and d) cooperate through a variety of operations including coinvestment, cofinancing, and reciprocal lines of credit, etc.

They may also perform the function of catalyst by operating as an instrument for the creation of markets and of financial instruments designed for customers that are initially theirs but that are later called upon to become involved with traditional commercial banks which, in turn, will incorporate into their banking activity enterprises that had not previously qualified for access to their services. In this way, development

and commercial banks will become interlinked through complementary financial functions.

The changes noted in development banks over recent years have shaped a new profile for those institutions. By way of example, they will be required in the future not only to have good corporate governance, but also to submit to continuous evaluation to gauge the impact of their activities and compliance with their mission as defined by their social mandate.