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RESERVE

ASSESSMENT OF THE IDB LENDING PROGRAMME, 1979-92

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ASSESSMENT OF THE IDB LENDING PROGRAMME, 1979-92 EXECUTIVE SUMMARY

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A BACKGROUND

Work has been carried out in a very close collaborative mode between the IDS team and IDB staff members. The study has benefited from the key support of William Robinson, who has been closely involved in all stages of the project. Alfredo Garcia has provided valuable support; the IDB offices in the three countries studied also supported and collaborated with the study, as did government officials in the three countries.

The project has benefited from having a Steering Committee at IDB, that has provided guidance, in the discussion of the terms of reference and detailed comments on an Interim Report produced by the team in late February 1993. The project also benefited from detailed discussions between its project coordinator and Dr Roy Culpeper, from the North-South Institute, who is coordinating a large study on multilateral development banks, including the IDB.

An important part of the study is devoted to producing a detailed profile of IDB lending to the Latin American and Caribbean region, in the 1979-82 period, and assessing this profile in relation to the IDB's objectives. These serve as a basis for policy recommendations. This study does not, however, carry out a detailed appraisal of impact on a project by project basis, (except to some extent in the case studies). This is due mainly because the time and resources available would not have allowed such an analysis in a rigorous way.

B MAJOR FINDINGS

1 The evaluation of IDB lending trends and the statistical analysis carried out (for 1972-1991) in the study show overall favourable distribution of IDB lending. For example, in the critical years for the LAC region, the post debt crisis period (1982-1991), the IDB was a loyal friend during difficult times, lending more to the more heavily indebted ones, at a statistically significant level. This is in contrast with private lenders, who drastically curtailed new lending to the region in that period.

2 Another feature of the inter-country distribution is that, at a statistically significant level, IDB lending per capita throughout the period analysed has a clear 'small country bias', that is the IDB lends more per capita to the smaller countries. This is caused both by political and administrative reasons, and by the fact that reportedly the IDB has specialized deliberately more in lending to smaller countries than for example the World Bank.

The IDB also lent more per capita during the 1982-91 period than in the previous period to those countries that had a higher share of exports to GDP; insofar as the share of exports is a proxy for countries' structural adjustment reforms and a response to debt pressures, this result shows that the IDB supported effectively those efforts in the region.

The IDB lent somewhat more per capita for the whole period to the relatively better off countries (though the effect is a fairly small one). This can be explained by our hypothesis that better-off countries borrow more because of greater absorptive capacity. However, to the extent that the objective of favouring relatively more the poorer countries with IDB lending becomes more crucial, special efforts need to be made, e.g. via technical assistance, to increase poor countries' absorptive capacities.

3 As regards IDB disbursements, to the LAC region, there is a steady overall increase from \$1.2 billion in 1980 to just over \$3 billion in 1992 (with a break in the upward trend only occurring in 1987). In real terms, IDB disbursements also increase during the 1980-92 period, but in a more erratic way; there was a substantial increase during the first half of the 1980's, followed by a fairly sharp decline (in the 1984-87 period), followed by an important recovery since 1987.

4 As regards IDB commitments, these have increased very significantly, from £1.8 billion in 1979 to \$5.7 billion in 1992. Particularly marked and important was the increase in IDB lending commitments that occurred since 1989, leading first to a recovery to levels similar to those of the early 1980s, and then leading in 1990 and particularly in 1991 and 1992 to levels of commitment well above those of the early 1980s. This very rapid increase of IDB lending commitments follows mainly the change to new management and the agreement of the 7th Replenishment. The decline in commitments in the mid-1980s was largely caused by the delay in the agreement of the 7th Replenishment.

The very rapid increase in IDB commitments in recent years implies that these are almost as high (by 1991) as those of the World Bank to the LAC region. This is in sharp contrast with the 1987-88 period, when World Bank's commitments to the region more than doubled those of the IDB.

5 As regards 'net cash flow' from the IDB to the LAC region (measuring disbursements minus repayment of capital and interest and subscriptions to the IDB, presented in our analysis as 3 year moving averages), for the region as a whole these rose during the first half of the 1980s, but then plunged sharply into deficit. A similar conclusion can be drawn if net cash flows are analysed in real terms.

However, the impact of the decline varied for different countries. Thus Group A countries plunged most severely into negative flows, while Group D countries (on the whole the poorest countries) have been relatively protected.

If countries are re-classified into four country groups, based on per capita GNP, it becomes even clearer that the poorest countries have been protected the most from adverse movements in net cash flows; they have maintained positive, albeit quite sharply declining, net cash flows throughout the period.

Also in per capita terms, net cash flows have - for the period as a whole - tended to be greatest to the poorer countries. For the most recent years (1990-92), the orientation of net cash flows to the poorest countries is less marked.

If net cash flows (also called net transfers) are divided into two sub-periods, it can be seen that during 1982-86 IDB net credit flows were positive (which was very valuable at a time of great foreign exchange scarcity in the region and of overall massive negative net transfers). Between 1987 and 1992, IDB net transfers to the region as a whole have, however, been negative (except for 1989). Problematic effects of such negative net transfers are somewhat diminished by the fact that total

net transfers from the region to its creditors first rapidly declined (1991) and then was dramatically reversed (1992). Furthermore, it is encouraging that at least for the poorest countries, IDB net cash flows were positive for all years in the 1987-92 period, except for 1991.

6 As regards sectoral distribution, the share of lending to agriculture has fallen from almost one third in 1979-81, to around 20 per cent in 1984-86 and to around 15 per cent in 1989-91. This raises doubts whether the target for share of total lending for rural development for the 5th and 6th Replenishment was fully met. Indeed, for the 5th Replenishment rural development IDB lending was at the bottom of the targeted range (30 per cent-35 per cent). For the 6th Replenishment, the actual lending for rural development and agriculture (at 21 per cent) was lower than the target (25 per cent-35 per cent).

It is noteworthy that even for countries in Group D, poor nations with large agricultural sectors, there has been a particularly sharp decline in IDB loans going to agriculture (from 47 per cent in 1979-81 to 7 per cent in 1989-91).

The share of loans going to social infrastructure, by contrast, has increased steadily during the period, from 15 per cent in 1979-81 to over twice that level (33.5 per cent) in 1989-91.

7 As regards lending vehicles, there has been a sharp decline for the region as a whole of FSO (concessional) lending, from 28.8 per cent in 1979 to only 5.3 per cent in 1992. The steady increase in the share of FSO in lending to Group D countries between 1984 and 1990 may have however, offset the impact on those countries, of the decline in overall FSO lending. If countries are again re-classified by income levels, it can be seen that in the past some of the relatively richer countries received FSO transfers. However, there is clear evidence that the targeting of concessional funds on the poor countries increased over the review period.

8 Comparing IDB disbursements to the region with total official flows to the region, IDB's share fluctuated between 15 per cent and 25 per cent during the 1980s, with its highest share in the mid 1980s; this was particularly valuable for the region as those were the worst years of the debt crisis.

9 The sharp recent increase in IDB lending commitments during the 1989-92 period is seen to have three separate but linked effects. One is increased foreign exchange availability for increasing imports, and increased availability for savings for investment. The second relates to the beneficial impact on the recipient economies of the policy conditions and dialogue accompanying IDB lending. The third relates to improvement in project design and implementation which seem to result as an effect of IDB's input (as highlighted in interviews carried out in Chile).

The increase in IDB lending in 1991 and 1992 does coincide with a period in which economic growth re-starts in the LAC region; though clearly IDB increased lending is not the main factor, in this resumption of growth, there is evidence that it is contributing to it.

10 The IDB - and particularly its President - played a very active role in discussing options and mechanisms for the region's external debt reduction.

The IDB, however, became directly active in debt and debt service reduction only in 1992. The most important operation of debt reduction in which the IDB has been involved is that of Argentina (see Argentina case study for details).

11 The IDB contributed to the LAC's region return to credit-worthiness. This has been done via two lines of action. One was via an 'exercise in optimism' spread extensively via IDB special conferences, meetings, speeches of senior management. The second line of IDB action was to support and encourage changes in the LAC region that helped attract foreign private flows. It is noteworthy that, of IDB's total sectoral lending since 1990, 33 per cent was in loans for the reform of the financial sector or for reform of investment.

Though positive in helping attract financial flows from abroad, it is essential that IDB conditionality and technical assistance for financial reform carefully balances liberalization and privatization in capital markets with appropriate supervision and regulation, (to avoid systemic failures in financial markets) and that it proceeds cautiously on liberalization of financial markets, because the financial sector is prone to market failure or market gaps.

Furthermore, when the IDB advocates positive real interest rates for low-income producers (e.g. farmers) that may be justified on efficiency grounds, it is important to evaluate the need for sufficient compensation to the losers, to avoid hardship. The possibility of a transparent, small, limited in time, subsidy to low-income producers could be contemplated, particularly if channelled to the financial institution carrying out the lending, to help it develop technologies that make such lending profitable and/or to help cover the higher administrative costs of bank lending to micro-enterprises.

Finally, as regards IDB conditionality relative to financial reform, the abolition of direct lending by national development banks could be slowed down, especially in countries with more incomplete private financial markets and for sectors where private financing is a serious bottle-neck.

12 As regards structural adjustment lending, the IDB has developed a special focus, by concentrating on particular sectors (e.g. financial, public enterprise reform, agriculture) and within sectors, that it knows intimately, such as energy.

13 In the 1980s the IDB did not devote sufficient attention to poverty alleviation. The 1990s seem to mark a sharp and very positive shift of emphasis towards lending for poverty alleviation.

However, as regards IDB lending which favours the poor, there is some evidence (based on UNDP figures) that in the late 1980s the IDB was devoting a **significantly** higher proportion of its total lending to lending actually benefiting the poor than either the other two regional banks and then the World Bank (assuming that IDB lending that reaches the poor is at least as effective as that of the other three institutions). This is consistent with the fairly widespread view that the IDB has been pioneering, among the multilateral institutions, in such vital areas such as education, health and - especially - provision of clean water and sewage systems.

Another point where IDB performance on poverty alleviation was positive, in contrast to the Bretton Woods institutions, was that during the first half of the 1980s it maintained its emphasis on poverty alleviation and emphasized employment creation as a mechanism to achieve it.

Indeed, a target was set for the IDB in 1979 (in the context of the negotiations for the 5th Replenishment) that 50 per cent of its lending programme should be directed to benefit lower income groups; during the 6th and 7th Replenishment, this target was renewed. Furthermore, in the 7th Replenishment, a specific incentive was created for

countries to present projects that would mainly benefit low income people; this allowed the percentage of total costs that could be financed in foreign exchange by the IDB to be supplemented by an additional 10 percentage point increase when at least 50 per cent of the projects' net benefits were expected to go to low-income beneficiaries.

However, as regards economic growth and poverty alleviation, it seems that overall, institutions like the IDB and the World Bank tended to focus far more on structural distortions that were policy induced (due to incorrect government action, such as financial repression) and on the whole tended to ignore or neglect structural bottlenecks to development related to the prevailing structure of particular societies (such as excessively concentrated land holdings).

In particular, policies to reduce poverty must, in addition to appropriate levels and distributions of spending on the social sectors, address other elements that produce and reproduce poverty. These include: 1) support for employment creation and/or productivity increases of the poor, and 2) policies that improve the primary distribution of income, for example via land reform. Land reform, where relevant, can have a favourable impact on growth and poverty. It does, however, require additional funding to make this politically viable, as well as for support of services. Future IDB lending could support such spending with its lending, where necessary.

14 In analysing the inter-country distribution of IDB lending to the social sectors, we found the traditional IDB country grouping (into A, B, C and D) as not particularly well suited for this objective. We therefore recommend that the IDB define a new classification of countries, to be applied especially when defining and evaluating credits to the social sectors or, more broadly, geared towards poverty alleviation. This report suggests a possible classification, based on income and a range of social indicators. Such a move would build on a trend already started in the 7th Replenishment, whereby the Group D category was split into two sub-categories, according to the level of GDP per capita.

A detailed analysis of the inter-country distribution of IDB lending to the social sectors (and particularly of IDB lending to the social sectors that reach the poor) shows that the IDB tends to lend more per capita to the smaller countries and those having the highest social development indicators (though some poor countries do receive significantly higher levels of per capita IDB social lending than other poor countries, and than some relatively rich countries).

15 In terms of average per capita lending by the IDB to the social sectors, it is important to stress its relatively low value. We estimate the average IDB lending per capita to the social sectors to the LAC region represents just \$1.5 (at 1980 prices) annually. This stresses the importance of the IDB's catalytic role in mobilising other sources of external funding and - even more importantly - to influence governments in the region to increase social spending, improve their efficiency, and their focus on the poor.

16 The fact that some of the relatively richer countries in the region (and especially the smaller, rich countries in Group C) have received higher levels of lending per capita to the social sectors than most of the poorer countries in the region may be to an important extent due to the fact that relatively richer countries have greater institutional capacity to absorb investments in the social sectors. To overcome this, the IDB should take specific actions to strengthen absorptive capacity in poorer countries. This would require the IDB to: i) carry out more in-depth analyses of poverty reduction possibilities, ii) focus technical assistance on poverty

reduction issues, by supporting project formulation and building institutional capacity in that sector and iii) devote high level officials to these tasks, who would be active in the field.

17 To further analyse the impact of IDB lending on poverty alleviation, we calculated, for every country, an equity index, which divides the share of IDB social sector lending estimated to be most likely to reach the poor, within the total IDB social sector lending to the region, by the proportion of the country's population under the poverty line within the region's total. Not only was the equity ratio very low for some of the poorest countries in Group D, but also for Brazil, where the share of IDB lending in total IDB lending estimated to reach the poor is 11 per cent, and that of the population under the poverty line is 40 per cent of the regional total.

Correlation analysis shows that per capita IDB lending to the social sectors tends to be higher for countries with higher income per capita and better human development indicators, showing a distribution more related to absorptive capacity than to need.

18 IDB lending to the education sector tends to be highest in per capita terms for the smaller and richer countries of Group C, though it is higher in the poorest countries (D) than in the relatively richer ones of Group A. For lending to health, water and sewage, lending to Group C and D countries is on average the highest, with Group A countries receiving the lowest per capita IDB lending; thus, in these sectors IDB lending seems to favour the more needy countries.

As regards the sub-sectoral distribution of IDB lending to education, it is interesting to note that, during the 1979-91 period, a very substantial proportion (over 60 per cent) was directed towards higher education.

It is important to stress here that the significant advances in education made during the 1960s and 1970s in the LAC region were reversed during the 1980s. Thus the rate of net matriculation, particularly in primary schools fell, while the number of pupils dropping out rose. This is particularly worrying as Latin America has still not achieved total coverage in primary education.

19 Poverty alleviation lending by the IDB also needs to consider the evolution of poverty in Latin America. Based on CEPAL estimates, we calculate that poverty in the region shifted from being a predominantly rural phenomenon to mainly an urban one. However, as regards extreme poverty, where incomes are insufficient to properly cover basic food needs, this is still predominantly a rural problem.

Furthermore, there is a great deal of evidence that poverty increased during the 1980s in LAC. Income inequality remains very high in relation to other areas of the world.

As regards health, in Latin America, there has been a dramatic decline in infant mortality. However, its decline is slower than in other regions, such as Asia. Furthermore, the decline in malnutrition in LAC slowed down in the 1980s, as a result of the economic crisis. It is estimated that for the region, the total undernourished population will increase from 55 million in the mid-80s to 62 million in the year 2000. Public expenditure on health declined fairly sharply in the 1980s, in the LAC region.

The existing pattern of IDB lending to the social sectors, the relative deterioration in poverty indicators in the region during the 1980s, and the decline of public expenditure in the social sectors during that period poses major challenges to the IDB, not only to improve its own performance in poverty reduction, (for specific recommendations, see below) but also to help catalyse efforts by LAC governments in this direction. The latter should include more and better targeted investment in education, health, water and sanitation, support for employment creation and/or productivity increases of the poor, and, where relevant, structural reforms, such as land reform.

20 Another source of some concern in relation to IDB's recent increased lending is the fact that future debt servicing to the IDB will increase significantly for some countries. There is evidence that sectoral loans may be a driving force towards generating negative net transfers towards the end of the 1990s.

However, a preliminary analysis would seem to show that the problem of IDB debt overhang and of future negative net transfers from the IDB at present, and, and for the rest of the decade, is not very serious for the region as a whole. However, to avoid future problems of IDB debt overhang and possible negative net transfers, there may be a case for some prudence in further expansion of IDB ordinary capital lending (see recommendations below).

As regards current levels of debt to the IDB, it should be mentioned that there are countries (particularly the smaller and poorer ones, such as Bolivia - see case study) for which debt to the IDB is a significant proportion of their external debt. Though their high exposure to the IDB could become problematic for those countries, their relatively small share in the IDB's portfolio implies they do not pose a problem for the IDB's credit-worthiness.

CASE STUDIES: ARGENTINA, BOLIVIA AND CHILE

21 The case studies (Argentina, Chile and Bolivia) carried out in the countries and after consultation with IDB staff in Washington offer more detailed insights into the IDB's lending programme. We will refer here mainly to conclusions of general interest, though some specific features of country situations will be very briefly stressed, to show the heterogeneity of countries and situations under which the IDB lends.

22 In 1992, Argentina became the country to which the IDB made the largest value of loan commitments (totalling over a billion dollars). Practically 100 per cent of these loans were policy-based. Strong and, on the whole, effective collaboration between the IDB and the World Bank characterizes loans to Argentina in recent years. The IDB has made valuable technical contributions to the reform programme, for example in helping make the privatization of electrical companies both successful and transparent.

23 The Argentine experience is illustrative for two main reasons. Firstly, it shows that conflict of priorities can overload policy formulation and implementation, especially when reforms occur in a context of macroeconomic fragility. Secondly, it illustrates that to a large extent the effectiveness of reform policies is dependent upon institutional capabilities as much as upon policy content. In particular, it shows that the rapid pace of reform policies since 1990 created a whole set of new issues, which requires a strengthening of public sector regulatory and supervisory roles.

24 The evidence from the 1991-92 period of policy based lending in Argentina shows that execution posed more problems than anticipated. Indeed, due to the stringent need for financial resources in past years, the breadth of commitments undertaken by the Argentine government did not match the institutional and legal capacity of the central Administration to deliver.

The type of problems referred to above are illustrated by the 1991 Provincial Development Programme, co-financed by the IDB and the World Bank. The loan was a policy driven loan, where the IDB only provided finance to provinces that meet strict financial performance and other criteria. Disbursements have been insignificant. The reasons range from domestic political ones (e.g. change to a ministerial team less committed to the programme) to inherent difficulties, which show the problems of financing policy (fiscal adjustment in the provinces) through projects, (which cannot be quick-disbursing).

Problems of slow progress, after a front-loaded fast first disbursement, also seem to characterize the Investment Sector and Provincial Development Loan, approved in November 1992. The problem that seems to be emerging is that too many sectors, too many agents and passage of laws (it is the Executive which signs loan contracts but Parliament that passes the legislation) are intertwined. Furthermore, the multiplicity of loan objectives poses difficulties for loan implementation.

25 Though reportedly the Argentine government is willing to start a social policy dialogue, it is concerned with its 'implementability'. This issue is seen as even more important for social policy in the future, than in macroeconomic adjustment, because ministries in charge of social sectors are much weaker than the Treasury. Indeed, in Argentina many of the implementation problems can be traced to poor public management.

26 In Argentina, as well as in Chile, there was much emphasis on the need to cut the time between project formulation and Board approval, as well as for the need of simplicity in project design. The need for such simplicity is also highlighted in the World Bank Wapenhans Report.

27 In the case of Chile, the IDB played a very significant role in helping reduce the negative net transfers abroad in the mid-1980s, thus limiting the decline in imports. Indeed, net transfers to Chile from the IDB were almost equivalent to those of the World Bank in the 1982-91 period, and were concentrated in the most difficult period.

28 As regards sectoral distribution of IDB loans to Chile, there has been a shift since 1990 to more lending to the social sectors (reflecting both the IDB's and the new Chilean government's priorities) and towards more innovative projects and programmes.

29 At present, though having very good relations with the IDB (and no significant disagreement with the IDB on conditionality), Chile is 'a reluctant borrower'.

The reason causing the Chilean government to be a reluctant borrower from the IDB may be temporary. They relate both to an increase in domestic savings (which seems more sustainable) and to an increase in foreign private flows (whose sustainability is less reliable).

30 Amongst the problems uncovered in IDB lending to Chile that of the perceived high cost of IDB lending relative to private lending was highlighted. Nevertheless it should be stressed that IDB lending (like that of the World Bank), even though at present more expensive than private loans for creditworthy countries like Chile, has significantly longer maturities. It also has greater value added in terms of help with project design, implementation and evaluation. However, alternative lending vehicles, (such as a single currency loan, in a currency like the US \$) could be useful, as a complement to the IDB's existing multi-currency loan. Such instruments need to be designed so that they are cheaper, but do not increase risk unduly. It is noteworthy that other multilateral development institutions (including recently the World Bank) have both multi-currency and single currency vehicles.

31 It is interesting that although some Chilean government representatives complained about the slow pace of IDB loan approvals, according to the IDB's Operations Department, the performance of projects in execution in Chile is exceptionally good. Indeed, of 15 projects in execution, 14 are without problems, and there is only one in the low category (the second best category). It would seem that this good outcome reflects both the very favourable economic environment in Chile and the overall positive relations between the Chilean government and the IDB.

32 The IDB has given valuable support in Chile (both financial and technical) to programmes with a clear poverty alleviation focus, such as the innovative programme of labour training for the unemployed (a programme which may be replicated by the IDB in Argentina and Venezuela, given its initial success in Chile). Furthermore, the IDB has made a very innovative loan to Chile for science and technology, which supports the Chilean government's aims to expand and diversify exports into products with higher intensity in technology and skills; this loan has innovative features, such as the sharing of risks and benefits between the government agency providing the funding and the private sector undertaking the technological research.

33 As regard the policy-based Investment Sector Loan made to Chile, this offers interesting lessons. Its benefits were largely indirect, as it helped Chile get credibility for its negotiations on a future entry to the WHFTA, and helped attract foreign private investment and financial flows. Policy conditionality was not so crucial, as to an important extent, the Chilean authorities were committed to these reforms, neither was the foreign exchange really needed, though this was less clear ex-ante. Though it played a fairly important role in the Chilean case, doubts need to be raised about the value of future loans under similar circumstances, both to Chile and other countries.

34 In the case of Bolivia, the IDB is its largest lender, with more than a quarter of its external debt in 1992, expected to rise to 36 per cent by 1997.

35 As Bolivia has such a high proportion of population dependent on agriculture, and as much of the poor population is in rural areas, it is somewhat surprising that IDB lending to agriculture represents such a low share of IDB total lending. Therefore the study recommends a stronger agricultural portfolio, particularly in regions and crops where poverty is most serious.

36 Several of the evaluation reports of IDB projects in the early half of the 1980s stress that much of the shortfall of operational performance in that period was due to the scope and magnitude of the macroeconomic and policy problems that then crippled the Bolivian economy (factors external to the project.) This again confirms

what the Wapenhans Report found for the World Bank, that the performance of projects was heavily influenced by factors external to the projects such as the policy and international environment.

37 The study detects (in April 1993) a case of informal cross-conditionality whereby disbursements on a World Bank loan had been stopped - even though Bolivia had fulfilled all the conditions of the World Bank loan - because the country was not fulfilling one of the conditions (on reduction of COMIBOL staff) of a parallel IDB multi-sectoral credit. This seems problematic.

38 The study also detects over-precision of IDB conditionality (e.g. in relation to cuts in staff or numbers of companies to be privatized), especially in relation to the precision of available forecasts about their effects on the Bolivian economy.

39 IDB's lending to the financial sector (via its Financial Sector Credit and Multisectoral Credit Programme) has effectively addressed the aim of helping to strengthen a very weak financial sector. However, it has not done enough to address the need for the poor's lack of access to financial services. It should, however, be said that the IDB is supporting some specific initiatives in this field, such as its support of Banco Sol, one of the most imaginative NGOs in the world and potentially a model for other ventures.

The small scale of IDB action in this field, however, suggests the need for a major expansion of the IDB's micro enterprise programme in Bolivia, and an extension of it from NGO's to banks.

40 Paradoxically, IDB leverage to apply conditionality in Bolivia may be weakened in future, because the IDB will need to disburse new loans, to provide finance for Bolivia to service its debt, much of which is owed to the IDB. As hinted above, IDB conditionality may in future also be weakened for countries, like Chile, but also others, while they have abundant foreign exchange and domestic savings, as they become 'reluctant borrowers', and therefore may well be unwilling to accept conditions inconsistent with the government's preferences.

Thus, the design of conditionality by the IDB must take account of what it is feasible to implement, given specific country contexts.

41 If, as seems highly desirable, the IDB's lending to Bolivia is to be expanded, the concessional (or FSO) component needs to be expanded, both to avert future debt repayments problems (which according to projections presented in the study could become serious, unless concessionality of new lending increases) and to facilitate the IDB's planned move into the social sectors.

C RECOMMENDATIONS

Our assessment has highlighted many positive features in the profile and performance of IDB lending over the 1979-1992 period.

However, to improve the impact of IDB lending in the region, nine recommendations are made:

1 IDB LENDING SHOULD BE MORE FOCUSED ON POVERTY REDUCTION EFFORTS

- a This implies that the IDB should shift its lending relatively more than in the past to poorer countries, poorer regions within the borrowing countries, provide additional incentives for poverty-oriented projects and - perhaps most importantly - shift to sectors where lending has a greater impact on poverty reduction. This implies more lending to the social sectors which benefit the poor and lending that supports production by - and employment of - the poor.
- b The IDB must not only focus on improving the targeting of its own lending on projects benefiting the poor (important as this is); it must also play a central role (via policy dialogue and possibly conditionality) in helping governments define appropriate poverty reduction strategies. This is particularly the case as IDB lending to the social sectors tends to be a very small share of total LAC governments' expenditure in this sector.

Where appropriate the IDB should support actions by LAC governments to reduce poverty which go beyond social expenditures and changes in the fiscal framework and include where necessary, structural reforms such as land reform and improvements in social equity.

- c The IDB has started a valuable dialogue with a number of LAC governments and actors in social sectors on defining new strategies for poverty reduction. It is important that a key role within this strategy is given by the IDB to education, basic health and the creation of productive employment. The lessons of recent history, show the particularly key role played by improvement in education and health, not only to reduce poverty, but also to enhance countries' competitiveness. For governments in the region to finance increased social expenditure in a non-inflationary way, further efforts may be required to increase government revenues (via taxation) and/or to restructure government spending. The IDB - via its' policy dialogue and loan conditionality - could play an important role in encouraging such trends.

2 THE IDB SHOULD SHARPEN THE FOCUS OF ITS LENDING TO PROVIDE INCREASED RESOURCE AVAILABILITY TO THE POORER COUNTRIES AND TO THE LOWER INCOME GROUPS IN ALL BORROWING COUNTRIES

While it is recognized that the IDB does need to lend to the relatively better off countries in the region in part to maintain its creditworthiness, the study concludes that the IDB could do more to assist in the development of the poorest countries. This would require an increased focus of technical cooperation resources and institutional strengthening to increase the absorptive capacity of these countries, particularly in the social sectors.

3 THERE IS ALSO A STRONG CASE FOR AS HIGH A PROPORTION AS POSSIBLE OF IDB LENDING TO THE POOREST COUNTRIES TO BE ON CONCESSIONAL TERMS

This will help meet those countries' development and poverty alleviation needs and to maintain the IDB's own creditworthiness. Particularly for lending to the social sector in the poorest countries, market profitability may often be far lower than social profitability, or a very long period may be required before such lending becomes profitable in market terms. Therefore concessional interest rates on IDB lending in such cases are essential to ensure that such projects with a high share benefiting the poor are financially more viable for the recipient government, and therefore more likely to be carried out.

There is also a purely financial case for an increase in IDB concessional resources, from their currently low level. As most of the poorest countries in the region still have large debt overhangs and their export growth has been and is likely to be less dynamic than that of the rest of the region, borrowing by them on non-concessional terms could impair their future capacity to service debt; this would be problematic both for the countries and the IDB. Both for equity and for financial reasons, there is a strong case for increasing concessional resources.

4 THE IDB (AND THE LAC GOVERNMENTS) NEED TO ADDRESS A WIDE RANGE OF DEVELOPMENT OBJECTIVES IN THEIR ACTIONS. THESE OBJECTIVES NEED TO BE DEFINED IN THE CONTEXT OF A SYSTEMATIC APPROACH TO COMPETITIVENESS

Not just general education and labour training, but also investment in higher education, and especially in scientific and technical training, acquire importance in such a context. Increased IDB lending in education is desirable not just to increase countries' competitiveness, but also to alleviate poverty and improve income distribution.

Another criterion for IDB (and LAC governments') activities is to act in sectors where there are clear market gaps or imperfections. Examples of this are protection of the environment, support for promotion of technological innovation and its' incorporation by private firms, and financing of infrastructure in cases for example where its private profitability is only realized in the long-term. Investment in infrastructure is also particularly important in future years due to the specific needs created by hemispheric integration.

5 THE IDB SHOULD RESPOND FLEXIBLY TO INCREASES IN THE SIZE AND IMPORTANCE OF THE PRIVATE SECTOR

The IDB may need to adapt its lending modalities and procedures to lend to the private sector (as discussed in the Chile case study). It also needs to increasingly support the new regulatory needs posed by the liberalization and privatization of the LAC economies, especially in sectors prone to market failure, like the financial sector.

**6 A LOWER SHARE OF IDB LENDING THAN IN RECENT YEARS SHOULD
BE CHANNELLED VIA POLICY BASED SECTORAL LENDING**

One of the main justifications of sectoral loans was their quick disbursing nature, crucial at a time of foreign exchange scarcity. While LAC countries have a more favourable balance of payments position, there is far less need for quick-disbursing loans, though it is desirable for the IDB to keep the flexibility to increase quick-disbursing loans should the balance of payments situation of LAC countries deteriorate. The IDB should place relatively greater emphasis on high quality investment loans in priority areas rather than on sectoral lending, especially those of a quick-disbursing nature.

Where policy based loans are provided, experience suggests great care is required in the sequencing of market liberalization and privatization efforts, along with the need for accompanying regulations in some market areas.

**7 THE IDB SHOULD EXPLORE WAYS TO LOWER THE COST OF IDB
ORDINARY CAPITAL LENDING**

This should be done by diversifying the portfolio of IDB lending vehicles to include other modalities that could lower cost without increasing risk. Such instruments could include single currency windows and especially a US dollar facility.

**8 THE IDB SHOULD SIMPLIFY ITS ADMINISTRATIVE PROCEDURES
ASSOCIATED WITH THE LENDING PROCESS TO REDUCE THE
TRANSACTIONAL COSTS TO BORROWERS**

Transactional costs often related to what the case studies found to be unnecessarily slow procedures should be reduced. This serves as a disincentive to borrowers. A review of IDB procedures to avoid excessive delays and over centralization of decision-making would seem important in this context. Improvements could possibly be achieved by delegating greater authority to local offices and to middle levels of Bank management.

This is particularly crucial for loans in high priority sectors, such as those for poverty reduction and social reform which involve numerous levels in the borrowing countries.

**9 CONDITIONALITY SHOULD MORE REALISTICALLY REFLECT
COUNTRIES' INSTITUTIONAL, ECONOMIC AND POLITICAL
CONSTRAINTS**

These recommendations have a number of institutional implications, for the IDB. These include the following six:

- 1 The need for staff re-training to fulfil new tasks (move to new sectors, to lending and regulating the private sector, etc).

- 2 The need to define a new classification of countries, to better reflect levels of income and social indicators. This will provide a better basis especially for planning and evaluating IDB lending for poverty reduction. This will continue the move in this direction already started in the 7th Replenishment (see above).
- 3 Provide more technical assistance to poor countries, in particular to support project formulation in the social sectors and in building technical and institutional capabilities for project implementation in those sectors.
- 4 Expand ex-post evaluation of projects, especially of assessment of poverty reduction impact of projects. During project design, allow and create flexibility to introduce variations that imply increased poverty reduction of projects and/or adaptation to changes in the environment external to the project. Emphasize and further develop mid-term evaluation during project implementation. This will require additional IDB resources, especially on location.

It would seem desirable for individual project evaluations to be complemented by an evaluation of the portfolio of projects by countries.

- 5 Improve relevant research capacity in IDB. This seems to include more research on: a) social indicators, and their evolution, so as to deepen knowledge of social and economic reality in the region, b) on macroeconomic analysis to determine both countries' borrowing needs, the impact of IDB lending, as well as the impact of macroeconomic policies on levels of poverty and c) meeting the challenges of the increased role of the private sector, both to support its' growth and to regulate it.
- 6 Where feasible, IDB operations should be decentralized and delegated more, giving greater authority to country offices and middle levels.