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THE FUTURE OF MULTILATERALISM

TIME FOR RENEWAL

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Regional Multilateral Banks in a New Global Context

The Experience of CAF - Development Bank of Latin America

Enrique García

THE WORLD economy has experienced a major change in the last quarter century. Emerging and developing economies have increased their share of global GDP from 40 percent in 1990, to 58 percent in 2015. These economies today represent more than 68 percent of the world's GDP growth. However, the gap between industrialized and developing countries is still substantial. In fact, there are very large unmet economic, social, and financial needs in the emerging and developing world. These require long term comprehensive strategies, profound structural reforms, and financial resources in amounts not available within their boundaries.

Multilateral development banks have traditionally played an important role in supporting development. Insufficient domestic savings and long term financing issues have hindered the achievement of stable, sustainable, and balanced economic growth. They are particularly relevant in times of macroeconomic difficulties for their capacity to apply counter-cyclical and catalytic instruments.

There is no doubt that—on the whole—multilateral development banks have been, are, and will continue to be, important instruments in the future, insofar as they have the capacity to adapt themselves to continuously changing economic, social, and geopolitical circumstances.

In the past, the main objective of multilateral banks was to attract long term external resources and channel them into the funding of new investment—mainly in infrastructure. Over time, their role has evolved in response to the ever-changing realities that developing countries have faced. In the process, multilateral banks have broadened their scope to include a number of activities and sectors. Indeed, beyond the original model of the World Bank as a global development bank, different initiatives and institutional models have emerged over the years at the regional, sub-regional, and national levels in response to new geopolitical and socio-economic realities.

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Photo: CAF

Enrique García at the Bank's headquarters

Other important reasons that more specifically justify the creation of regional development banks—and also explain their comparative advantage—include closer proximity to their clients and a broad knowledge of the idiosyncrasies of the region in which they operate. Nonetheless, their success has relied to a great extent on their capacity to articulate a vision of development, define a clear mission, and obtain the solid commitment of their member countries to that mission—as well as having the ability to mobilize external resources based on their institutional strength (both administrative and financial).

A Great Achievement

Multilateral development banks are one of the most significant institutional inventions of the twentieth century. The World Bank was established in 1944 with the goal of helping rebuild the economies of Europe and Japan after World War II, with an additional mandate to promote economic growth in the developing countries of Africa, Asia, and Latin America. Since the beginning of its operations until the early 1960s, the World Bank focused its efforts mainly in the energy and transportation sectors. In turn, it created the International Finance Corporation as an instrument to support the private sector.

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Then came the Inter-American Development Bank (IDB). Created in 1959, with the United States and the countries of Latin America and the Caribbean as founding members, the IDB began operations in 1960, as the world's first regional development bank. In the late 1960s, Canada joined as a member, and later the IDB expanded its membership to include some European and Asian countries. Other regional initiatives include the Asian Development Bank, the African Development Bank, the Islamic Development Bank, and the European Bank for Reconstruction and Development.

In the 1960s, integration processes in Latin America experienced a major boom, creating a favorable environment for the emergence of new multilateral initiatives in the region. In this context, inspired by the founding of the IDB, and with its support, sub-regional institutions were created. These included the Central American Bank for Economic Integration (1961), CAF – Development Bank of Latin America (1968), the Caribbean Development Bank (1969), and the Financial Fund for the River Plate Basin (1969). More recently, new initiatives have appeared, such as Banco del Sur and Banco del ALBA, though these are still in initial stages of operations.

Origins

As an interesting example of a regional institution that is owned by emerging market countries—and therefore different in this aspect from most regional development banks worldwide—it is worth emphasizing some of the key factors that have characterized CAF's transformation. Over the past 20 years, CAF has grown from five shareholder countries to 19. In addition to founding members Bolivia, Colombia, Ecuador, Peru, and Venezuela, its shareholders now also include Argentina, Brazil, Barbados, Costa Rica, Chile, Spain, Jamaica, Mexico, Panama, Paraguay, Portugal, Dominican Republic, Trinidad and Tobago, and Uruguay, as well as 14 private banks in the region.

Additionally, and pursuant to an amendment to the CAF Articles of Agreement that entered into force in 2008, countries in Latin America and the Caribbean, beyond the original founding members, are allowed to become full members—an option that has been exercised to date by Argentina, Brazil, Panama, Paraguay, Uruguay, and Trinidad and Tobago. This has put them at the same level as the original Andean founders. Because of this, CAF changed its full name from the Andean Development Corporation to CAF – Development Bank of Latin America in 2010.

> *The Bank's authorized capital is $15 billion, while paid-in capital plus reserves from retained earnings (net worth) is more than $9.5 billion.*

CAF began operations with authorized capital of $100 million and subscribed capital of $25 million. Today the Bank's authorized capital is $15 billion, while paid-in capital plus reserves from retained earnings (net worth) is more than $9.5 billion. The assets of the institution have increased from $160 million at its inception to about $32.5 billion today. Four capital increases—totaling $8.2 billion—which were subscribed by the member countries in the last 10 years, will allow CAF to approve new loans totaling $100 billion during the period from 2016 to 2022.

The increase of CAF's lending to shareholder countries has witnessed a similar expansion. In its first 10 years of existence, CAF approved operations with a total value of $600 million, for an annual average of $60 million. In the period between 2011 and 2015, total approvals were $55 billion (an annual average of $11 billion).

Likewise, since the 1990s, CAF has significantly expanded its financing scope to include infrastructure, social development, environmental protection, capital market development, support to industrial activities, mining and tourism, and institution-building—both in the public and private sectors. In the early 1990s, about 40 percent of CAF's loan portfolio was made up of trade finance operations, with the rest being programs and project loans. Currently, over 90 percent of the Bank's portfolio consists of programs and projects in the aforementioned sectors.

CAF is the main source of multilateral financing for the Andean countries, whilst also having become one of the most important financial sources for all of Latin America, alongside the IDB and the World Bank. Indeed, while CAF accounted for less than five percent of multilateral financing in the region in the 1980s, today it provides about 34 percent of funding. Most notably, it has taken over the top spot in recent years in terms of approved financing for infrastructure development, including energy. At the same time, CAF has become a relevant player in terms of financing the private sector—not only through direct financing, but also though its value added catalytic role.

Moreover, in recent years the institution has significantly increased its participation in financing the social sector, the environment, and the promotion of micro-, small-, and medium-sized enterprises—both directly, and through a network of public and private financial institutions and specialized funds established for this purpose. It has also intensified its advisory activities and financial structuring, as well as its use of catalytic instruments—such as partial guarantees, co-financing, structured financing of projects, subordinated loans, and participation in investment funds—to name just a few.

The Bank has positioned itself as a forum for regional and international debate on Latin American development issues, and has succeeded in forging important links with leading universities, think tanks, and academic communities worldwide.

One area in which CAF has consolidated its leadership is in regional integration. Over the past 20 years it has technically, institutionally, and financially supported the execution of more than 69 projects involving physical cross-border integration—with a total investment of about $28 billion and direct funding surpassing $9.8 billion. These projects were mainly related to roads, transportation, communications, energy, logistics, and the environment, as well as other comprehensive cross-border development initiatives.

In terms of borrowing in international capital markets, CAF has had an interesting evolution. Until the early 1990s, CAF operated mainly with capital contributed by its members and with short and medium term external funding provided by export-import banks and development agencies in industrialized countries. Currently, over 89 percent of CAF's external funding is obtained from capital markets and international banks. Since 1993, CAF has carried out 128 bond issues—raising more than $23 billion—and implemented a commercial paper program that periodically issues short term notes. CAF's activities in capital markets is diversified when it comes to both terms and places, operating in the United States, Europe, Asia, Oceania, and other regional markets.

All this has been made possible due to the Bank's consistently solid financial position over the years, which led to CAF obtaining its first investment-grade credit rating of BBB in 1993 (and 13 consecutive ratings upgrades since then). In the second half of 2012 and the first quarter of 2013, Standard and Poor's, Moody's, and Fitch raised CAF's credit rating to AA- or equivalent, while the Japan Ratings Agency upgraded CAF to AA; these ratings are substantially higher than those of its shareholder members, and give CAF a competitive edge in capital markets.

Furthermore, in parallel to the political decision to keep more than 95 percent of its equity in the hands of countries in the region, CAF has strengthened its Latin American dimension. Yet, at the same time, it has progressed in fostering cooperation with the rest of the world in ways that neither affect its idiosyncrasy nor its Latin American identity. Accordingly, beyond its presence in international financial markets, CAF has signed cooperation agreements with countries outside the region and around the world, including development banks, export agencies, and research and technical cooperation centers of various countries from the Western Hemisphere, Europe, Asia, and beyond.

Furthermore, through its knowledge-generation agenda, the Bank has positioned itself as a forum for regional and international debate on Latin American development issues, and has succeeded in forging important links with leading universities, think tanks, and academic communities worldwide.

Key Factors for CAF's Transformation

The transformation of CAF has been the combined result of strong support from its shareholders through continuous and substantial increases in capital, impeccable debt service by member countries, strict compliance with all contractual obligations, and non-interference with the institution's professional management.

But there is more to it than that. Indeed, a determining factor for success has been the fact that CAF is essentially a Latin American-owned institution—which at first glance might seem to be a limiting factor for growth, given the absence of AAA and AA level countries from the industrialized world, as is the case with similar institutions.

In this context, it is worth examining the main strategic components that have contributed to the strong support for the Bank on a wide range of issues, such as CAF's vision of the development process, its fields of action, policies, products, and services, as well as the characteristics of its governance system. Six factors have been critical to the transformation of the institution and are worth emphasizing.

The first factor is a visionary constitutive agreement, one which, in fact, has become the cornerstone that has enabled CAF to reinvent itself periodically and thus to respond and adjust to changing scenarios and conditions in the geopolitical, economic, and social realms—both globally and regionally. A good example is the decision made in the early 1990s to open its doors to other members in Latin America and the Caribbean, which allowed CAF to extend its vocation for regional integration and its operational base beyond the Andean region.

It is worth mentioning that a key element for the incorporation of new countries was precisely the emphasis given to sustainable development and regional integration in CAF's mission statement, which was updated in 1993.

The second factor is the comprehensive development agenda that CAF adopted in the early 1990s, which serves both as a guide and orientation for its operations, and is periodically updated in response to the dynamic evolution of global and regional conditions.

This updated agenda aims to achieve fast, sustained, sustainable, and high-quality economic growth: *fast growth* to bridge the development gap with respect to high-income countries; *sustained growth* to avoid volatility and ensure the continuity of economic progress and social welfare; *efficient growth* supported by a productive transformation and a competitive expansion in international markets; *equitable growth* to permit fair and inclusive participation for a majority of citizens; and *sustainable growth* to ensure the permanence of the region's human and natural capital from one generation to another, whilst respecting cultural diversity and the environment.

Thus, the absence of donor countries from the developed world turns an apparent weakness into a strength by generating a sense of mutual loyalty.

The third factor is the regional membership composition of the institution. In the conceptual model of traditional development banks, there are two types of members—industrialized and developing countries—whose benefits are defined as follows: development countries receive the benefit of technical, financial, and institutional support to perform programs and projects; whereas industrialized (donor countries) are not eligible for financing, but do benefit from the procurement of goods and services, and certainly by conceptual and political influence in the institutions.

During the mid-1990s, CAF made a decision to maintain its regional identity. This means that countries in the region hold a large majority of shares and voting power, and that CAF does not have two categories of members. In fact, of CAF's 19 shareholder countries, 17 are Latin American or Caribbean countries. Together, they control 95 percent of the bank's capital. There are only two non-Latin American countries—Spain and Portugal—which are also eligible to access loans, technical cooperation, and other products and services. Likewise, CAF has not limited procurement to its member countries. In other words, procurement is open globally.

The fourth factor is CAF's competitive access to international capital markets. In light of the decision highlighted above, it has been critical for all shareholder countries to protect the institution's health and financial soundness. This is an essential ingredient to ensure that CAF attains the highest possible credit ratings. This allows the Bank to tap into capital markets and other internal and external financial sources, as well as to meet, in a sustainable way, the development needs of the region's member countries. All this is creating a genuine sense of shared responsibility among member countries, furthering the already high level of commitment to the success of the institution. Thus, the absence of donor countries from the developed world turns an apparent weakness into a strength by generating a sense of mutual loyalty. In fact, during CAF's 40 years of existence, no country has defaulted on any financial, statutory, or other obligation.

In this context, beyond maintaining adequate financial indicators and policies, it has been essential for CAF to attain and maintain a high level of paid-in capital relative to total capital. Other institutions have OECD countries with AAA or AA credit ratings among their major shareholders. For institutions such as CAF, in which the majority of shareholder countries do not enjoy such credit scores, what is really important is not the guaranteed or callable capital—as in the case of the World Bank or the IDB—but rather the paid-in capital and retained earnings.

The fifth factor is CAF's model of corporate governance. In this regard, the existence of a non-resident and high-level board of directors, composed of ministers and senior government officials who are, in effect, simultaneously Governors of the

World Bank, the IDB, and most other multilateral institutions, is indeed a significant asset. Moreover, the fact that the voting system is one-director, one-vote—regardless of the relative differences in equity participation by each shareholder (as is the case in the traditional model of multilateral banks)—provides for a much more balanced decisionmaking system. In fact, it is one that is more flexible and less prone to political influence beyond the specific activities and operations of the institution. In addition, the board has the final authority to make decisions on most key policy issues.

It is the banker who supplies the umbrella and opens it when it rains, because on sunny days it is not needed.

This model of governance also involves a high level of delegated authority to management, acting as a shield against political or any other type of interference in the operation of the institution by shareholder countries.

Finally, the sixth factor is CAF's philosophy of not trying to impose models or one-size-fits-all solutions on shareholder countries. In addition, CAF's corporate culture is predicated on full respect for ideological differences, and the Bank's decision to be continuously present in all member countries—especially in times of crisis.

These six factors have made CAF an interesting case study that has been analyzed by newly-created multilateral banks, such as the BRICS New Development Bank. Since its founding, CAF has time and again proven that it is a loyal and supportive partner. It is the banker who supplies the umbrella and opens it when it rains, because on sunny days it is not needed. Moreover, the institution has played an important catalytic role by raising funds from other sources to channel them, along with its own resources, to finance projects and activities in the region. The ability to fulfill this role is a critical factor for the success of any development bank.

Final Thoughts

It is important to reaffirm the fundamental role played by multilateral development banks in Latin America, particularly regional banks. The question that frequently arises concerning the need for new regional banks—and even about the relevance of those that currently exist—can be answered simply by considering the investment and financing needs of the region.

Multinational development banks in Latin America are critical to advancing hopes of achieving high and sustained growth rates. This would enable the region to attain similar levels of per capita income as the industrialized countries within 20 years, while at the same time ensuring genuine inclusion and social equity.

Beyond the existing multilateral banks, there is room for the creation, or strengthening, of other regional institutions, such as the BRICS New Development Bank and the Asian Infrastructure Investment Bank. However, the viability and success of these initiatives will depend largely on their being built on solid foundations that combine a clear geopolitical and developmental vision with a technocratic approach—at once both rigorous and innovative.

The success of regional development banks will depend on their professional management, financial soundness, ability to attract global financial resources, and the technical and intellectual capacity to promote comprehensive development agendas.

The success of regional development banks will depend on their professional management, financial soundness, ability to attract global financial resources, and the technical and intellectual capacity to promote comprehensive development agendas. In a complex global economy environment, the capacity of these institutions to adapt becomes critical, and their catalytic role more important than ever.

Latin American countries are faced with the crucial challenge of achieving fuller development for their citizens. The institutional architecture of the region must support this task and, in the process, continue to improve its performance—especially with regard to knowledge-oriented services. That evolution should be guided not only by purely economic and financial considerations, but also from the perspective of the positioning of Latin America in the context of globalization, and through the revitalization—with more force than ever—of regional integration.