



**FIRST REGIONAL CONSULTATION ON THE CHALLENGES OF THE NATIONAL  
DEVELOPMENT BANKS IN LATIN AMERICA  
(Lima, Peru, June 12 and 13, 2006)**

**Introduction**

1. In its Resolution 58/230 of December 23, 2003, the United Nations General Assembly requested the United Nations Financing for Development Office “to organize workshops and regional multi-stakeholder consultations, including experts from the official and private sectors, as well as academia and civil society, to examine issues related to the mobilization of resources for financing development and poverty reduction” and “to convene activities involving various stakeholders to promote best practices and exchange information on the commitments made and agreements reached at the International Conference on Financing for Development, held in Monterrey, Mexico, in March 2002. In response, the Financing for Development Office, in cooperation with important institutional and non-institutional stakeholders, launched a series of events in 2004-2005 to explore and select topics relating to financing for development that could, through discussions between experts and those multi-stakeholders, contribute to the policy debate in international fora. A series of regional consultations were then scheduled for 2006-2007 to explore ways to enhance the role of national development banks in promoting economic and social development.
2. The first regional consultation promoted by the United Nations within the framework of the “Multi-stakeholder Consultations on Rethinking the Role of National Development Banks” initiative, entitled “The Challenges of National Development Banks in Latin America”, was organized by ALIDE with the collaboration of the Corporación Financiera de Desarrollo S.A. (COFIDE), of Peru, for June 12 and 13, 2006, at ALIDE headquarters in Lima, Peru. The main purpose of the meeting was to seek the intellectual input of a representative group of experts from the region in regard to the evolving role of development banks; their functions and instruments; the improvement of their effectiveness; and their future efforts. The Meeting was attended by renowned experts from the official and private sectors, from Latin American, Chinese and South African development banks, from international and cooperation organizations (ECLAC, CAF, CAN, IMF, IDB, IFAD, GTZ, OAS, etc), from academia and from civil society.
3. After each of the sessions, the experts were invited to answer questions and exchange viewpoints with the audience about the particular experience of each institution or country with regard to the subject matter of the presentations. The agenda for the Meeting and the list of participants are attached at the end of this Report (see annexes 1 and 2, respectively). The presentations made by the group of experts and the background documents for the meeting may be consulted at the following Internet addresses:  
[http://www.alide.org.pe/download/Varios/Consulta\\_Regional/index.htm](http://www.alide.org.pe/download/Varios/Consulta_Regional/index.htm) and  
<http://www.un.org/esa/ffd/ndb-peru.htm>.

4. The Report follows the Agenda for the Meeting, covering the following sessions: (1) opening of the Meeting; (2) the evolving role of national development banks; (3) filling the gaps: functions and instruments of national development banks; (4) enhancing the effectiveness of national development banks; (5) national development banks in the future; and (6) the closing of the Meeting and the next steps in the regional consultations.

#### **SESSION 1: OPENING OF THE MEETING**

5. The participants in the opening session were Messrs. José Antonio Ocampo, Under-Secretary-General for Economic and Social Affairs of the United Nations; Rommel Acevedo, Secretary General of the Latin American Association of Development Financing Institutions (ALIDE) and Daniel Schydrowsky, President of the Corporación Financiera de Desarrollo (COFIDE), of Peru.
6. Mr. Acevedo remarked in his welcoming statement that much has been written and said about the role of national development banks (NDBs) and their good judgment and virtues because of the proven impact of their efforts on the development of the productive and social sectors, but also -- due to the influence of schools of thought prevailing in the region-- about their mistaken judgments as reflected in the closing or merger of those institutions in several countries. He then briefly described some identifying elements of NDBs and concepts and practices for promoting or enhancing their development, profitability and efficiency.
7. He went on to stress several points: first, the need to emphasize that in the region's countries the generic name development bank or development financing institution covers a considerable variety of institutions and mechanisms that include banks *per se*, finance corporations, and development and financial agencies. Second, that the degree to which these institutions are financial intermediaries varies, but that in most cases they perform this function, even if not exclusively. Third, that the general and ultimate aim of the activities of NDBs is to promote and finance projects and activities that are both in keeping with the development priorities of the economies in which they operate and at the same time financially viable. Fourth, that an NDB may be operationally organized to serve a single economic sector or several of them. Multisector banks may be assumed, in principle, to have portfolios with greater risk compensation and in which the probability of bankruptcy is reduced overall. A more focused analysis of the correspondence between risk levels and asset composition, however, demands that the universe of borrowers be broken down by types of economic units. This could lead to the conclusion that in certain cases the primary element for defining a bank's specialization is the type and/or size of its clients, with its sector of operation as a secondary element. Fifth, he added that NDBs use several instruments to fulfill their objectives, which include financing --particularly medium- or long-term financing-- for the investment component of the projects and activities they support and the provision of promotional services, technical assistance and other credit-complementary services.
8. Mr. Acevedo stressed that recent experiences in Latin America and the Caribbean reveal, among other things, that the traditional idea of a development bank as a simple instrument to distribute subsidies via credit has evolved to encompass a new function: that of medium- and long-term financing, which demands that these institutions be equipped to meet the characteristic objectives of development promotion while, at the same time, they strengthen their position as financial intermediaries in an increasingly competitive environment. He stated that just as policies of direct intervention are born of needs created by market failures or shortcomings, NDBs are justified by the existence of those needs or intervention policies. Consequently, the success of those interventions will depend upon the quality of the policies, the effective operation of those institutions, and the substantive agreement between the two elements. NDBs were created to

provide financial services to sectors and credit recipients that other intermediaries found too risky or simply ineligible.

9. As for the field of development banking operation in the next few years, Mr. Acevedo stressed that it appears to be two-fold and can be described as boosting financial development by introducing instruments that increase the availability of medium- and long-term resources and instituting operational policies for supporting branches of activity that can make a greater contribution to economic growth and further the development of business and technology, particularly of micro, small and medium enterprise (MSME). In this connection, the efficiency of NDBs will depend upon and be subject to the fulfillment of their entrepreneurial function, as well as their social or institutional function. The *institutional efficiency* of NDBs is tied in with aspects like their capacity to provide access to credit to sectors with high economic and social priority that are not served by commercial banking; the influence they can exercise over the creation of new businesses, promotion of new investments and generation of employment; their contribution toward promoting technological innovation and adaptation; their promotion of entrepreneurship development; and their credit-complementary services, etc. The *operational or entrepreneurial efficiency* of NDBs, for its part, is expressed through their compliance with banking standards similar to those of any private financial intermediary, with the observance of adequate levels of banking profitability and solvency. A sound situation is today, more than ever, essential for fulfilling their mission.
  
10. In concluding, he emphasized that in recent years NDBs have been assuming a new profile. Their efforts today are framed within a new concept of promotion that has nothing to do with interest rates that are too low to cover costs, but with the efficient and well-timed provision of financial and non-financial services to sectors that have not traditionally enjoyed access to credit. Furthermore, NDB support is no longer conceived as being indiscriminate for projects and clients of all kinds, but is now selectively provided according to the social and private profitability of the projects and the need to cover bank costs and to produce a reasonable profit for the NDB. In proposing that NDBs adjust to the new global context, however, he pointed out that it is not possible to propose a single system, because a great deal depends upon the characteristics of the particular country and the orientation and general priorities of its government. What is true, as a universal principle, is the need for absolute coherence between institutional and instrumental objectives, functions and mechanisms at the moment the mission and operational guidelines and mechanisms are established for the NDBs. Also, that the legal and statutory systems of the NDBs be free from political interference and that they be endowed with adequate autonomy of operation. The role NDBs will play in the future will be determined by the challenges the economies must face, summarized as follows: (a) the need for sustained, stable growth rates in order to create the well-paid jobs the people demand, and above all to help overcome the problem of extreme poverty; (b) higher levels of productivity and competitiveness; and (c) balanced regional development that respects the environment, together with more integrated production chains, particularly those associated with export activities.
  
11. Mr. Schydrowsky drew attention to several special lines in the work of NDBs, like providing credit and financial access at sustainable interest rates that would not otherwise be available in the market; and creating the financial infrastructure to make that possible. In COFIDE's case the challenge is how to reach the final user, inasmuch as its operation as a wholesale bank limits its sphere of action. In this connection, he referred to an approach he calls "the Coca Cola model," in which although the company does not deal directly with the public, its product reaches a huge universe of consumers through a wide-ranging distribution network. Using this model, COFIDE has developed programs and products that have allowed it to approach the final client, but always

while operating strictly as a wholesale bank. Brief summaries are given below of four examples presented by Mr. Schydrowsky:

- a) ***COFIGAS Program:*** To promote the use of natural gas in factories and vehicles, particularly taxis for public service, whose owners are not credit recipients. A “chip” is attached to the fuel tank of each vehicle and is recognized by the natural gas pump at the moment the tank is being filled. This program benefits the client because the entire loan process is carried out rapidly and easily through financial intermediaries, inasmuch as COFIDE does not deal with the final client. There is a saving of approximately 50% in using natural gas instead of gasoline and the loan is repaid as the gas is purchased. And by joining the formal system, the client becomes a credit recipient and can therefore draw on that credit for other purposes.
  - b) ***Las Únicas Program:*** These are very small savings and loan associations in areas of extreme poverty that consist of between 10 and 20 families, each of which buys a 10-sol (approximately 3 US dollars) share and is trained by COFIDE. These associations have enabled their members to take out loans at 6% a month, instead of the rates starting at 30% a month they were being charged by informal lenders or speculators. Members also earn 4% a month on their deposits. The first result, then, is an efficient sub-function of external credit, in which the lower interest rates paid on loans because the members borrow from each other, instead of from third parties, produce an important saving in efficiency. Furthermore, about one thousand hectares are currently under cultivation with the support of las Únicas, making the Program’s implementation one way to give the population living in extreme poverty a market, and eventually a credit market, vision.
  - c) ***Standardized Financial Products (PFE):*** In the traditional scheme, because of asymmetric information problems, agricultural borrowers who are not known are asked for loan guarantees. Since many of them lack this collateral, the interest rates that are charged are very high. In response to this problem, COFIDE created the PFEs, which lend to the “production process,” rather than to the individual. Care is taken to see that the process is specified in detail, that quality inputs and state-of-the-art technology are used, that the market and post-sale of the output are guaranteed, that the price is tied to an external indicator in order to avoid a last-minute monopsony, that a coordinator will ensure that everything functions properly and that there is a technical advisor. All of this is packaged within the legal concept of a trust-guarantee in which all of the contracts are specified and because everything is guaranteed, the risk is reduced enormously. Instead of charging a risk premium of 20%, the risks are broken down and the coverage is provided in the productive sector. With this market interaction structure, loan interest for the farmer is reduced from 40% in real terms to 14 or 15% a year, and includes an insurance premium to cover the residual risk.
  - d) ***Support Program for Sub-national Units:*** Peru is in the process of decentralizing and transferring budget funds to sub-national units (regional governments and municipalities), which need financial support, intermediation and risk coverage. When the counterpart risk is too high, COFIDE’s role as an NDB is to work with those sub-units and to act as an intermediary so that the new regional governments can participate in the market. Furthermore, in markets where these sub-units are unknown, where they have no established reputation, COFIDE offers them another way to package a product.
12. Mr. Ocampo, in his presentation at the opening session, said that there is talk in the United Nations Financing for Development Office that consultation mechanisms are one of the basic instruments for following up on the Monterrey Summit. A first round of consultations has accordingly been held on inclusive development, which refers to the entire area of microfinance and, as a result, a book was published entitled “Building Inclusive Financial Systems.” He also explained that consultations have been held on international systemic problems and on Public Private Partnerships (PPPs) and that the expectation in this round that is being launched with the

First Regional Consultation on “The Challenges of National Development Banks in Latin America” is to carry out consultations in each region of the world. In regard to the subject matter of the consultation, Mr. Ocampo emphasized the diversity of NDBs, as to ownership structure, operating modality (retail, wholesale or universal bank) and sector orientation, among other things. He stated that development banking is somewhat complex, but that it should be conceived more in terms of functions, than of the institutions *per se*, because it is through those functions that one can determine and recognize that it has a public function in all cases. He also stressed that the most productive part of the meeting is the presentation of concrete experiences of NDBs both in and outside the region because these, and not just the conceptual analyses, will help build an understanding of how they operate in practice and how the United Nations can propose a new and different way of viewing the subject of development banking in the twenty-first century.

13. In the context described above, Mr. Ocampo addressed the subject on two levels. The first is why are development banks needed? In order to understand this, he considered that the starting point must be two basic concepts: the positive externalities and subfinancing by the private sector. The latter refers to the fact that, somehow, the private sector does not develop automatically, even if the market is relatively developed. This means that institutions are needed to boost this development in some way. The four major problems that generally exist in all markets are: (a) **access** to the financial systems is limited even in developed economies, but is even more so in developing economies. In order to meet this problem, actions targeting the microentrepreneur must be taken to facilitate access by SMEs under reasonable conditions in both urban and rural areas; (b) **term**: Financial markets are generally biased toward the short term, particularly when they are less developed. Long-term financing is always an underlying problem, which is now being resolved more by the capital market than by the banking system, for it is the debt bond market that is growing most heavily today and offering increasingly longer terms. Together with this, we have the mortgage market, which in some countries like Chile have shown tremendous growth. The creation of NDBs in the past was essentially due to the timeframe problem, but their operation today is more attuned to their interaction with the bond market than directly through the banking system; (c) **volatility**, as a result of the fact that access is cyclical. There are periods when access to the financial market is rapid and others when it is not. This is a phenomenon that is both national and international and that shows signs of worsening day-by-day. During boom periods, private markets cover the necessary financing and there is no need to turn to international organizations, but the opposite occurs during crises, when these institutions fulfill the role of principal financiers; and (d) **risks in addition to term and economic cycle risks**, which could include the risk of currency mismatches, risks associated with uncertainty over certain forms of innovation, or regulatory risk.
14. The second level is what should the role of NDBs be? Mr. Ocampo concentrated on the nature of the activities financed and, as a result, on the externalities that are created by the projects NDBs support. He referred to science and technology, education, the environment, and infrastructure, and to how innovation activities in a broad sense are financed. In the case of innovation, he commented that this concept is generally associated with technological innovation, when in reality, technological innovation in a developing country refers more to copying than to conquering new markets or territories, or new sources of raw materials. All of these forms of innovation should be supported because they, of themselves, represent a certain level of uncertainty or risk. It is important in the new world and national contexts to finance sectors that generate positive externalities. Even so, it should be borne in mind that private markets today are far more developed than in the past, when there was talk about the absence of agents. It was in that context that many NDBs were created in Latin America, such as the rural banks and the industrial finance institutions. At the same time, institutions were created in industrialized countries, like the EXIMBANK in the United States, reflecting an important failure of the market that was identified in the 1930s. The situation today is very different, with a

far more developed private financial sector. The question to be asked in this particular case is how to make the public function more one of helping create those markets than of seeking to replace them. In other words, the matter is how to leverage the creation of new markets through public action, so that NDBs act more like catalysts than agents replacing the market.

15. Mr. Ocampo concluded by referring to government failures. He stressed that these have to do with problems of different kinds and obviously with the management of the risks it assumes and with the way it finances itself. As a result, the first point he emphasized was how are risk management systems established in public or mixed finance institutions? This, in turn, has to do with the politicizing versus the autonomy of the institutions. Many institutions went bankrupt in the past because they were forced to assume risks they were not equipped to handle. The question to be asked then is what should the governing rule be for reasonably managing risks that are public? The crux is how to create a certain degree of autonomy while at the same time public regulations are established that must be complied with? By way of example, some NDBs had systems for financing the subsidies they were forced to assume in the past that had a financial design and rules. Today these systems have largely disappeared, but not completely. In some countries, like the United States, there is a system of forced investment, which includes the obligation for all financial institutions to allocate a minimum percentage of their portfolios to poor sectors. Therefore, there may be rules that compel these institutions to self-finance these subsidies. If the subsidies are legitimate because there is a legitimate public objective, then they can be subsidized. What is not correct is to grant subsidies without financing them properly and without determining who will pay for them. The cost of the subsidies must be carefully estimated and there must be a mechanism for financing them in a clear and transparent way.

## **SESSION II: THE EVOLVING ROLE OF NATIONAL DEVELOPMENT BANKS**

16. Mr. José Antonio Ocampo, United Nations Under-Secretary- General for Economic and Social Affairs was the chairman/moderator of the Session and the keynote speaker was Mr. Daniel Titelman, Coordinator of the Special Studies Unit of the Economic Commission for Latin America and the Caribbean (ECLAC) (Santiago, Chile). The panelists were Messrs. Ernani Torres, Director of the Economic Research Department of the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), (Rio de Janeiro, Brazil); Mauro Sartori, Manager of the Office of Planning and Risk of the Banco de Comercio Exterior de Colombia S.A. (BANCOLDEX) (Bogotá, Colombia); and Romy Calderón Alcas, Head of the Economic Studies and Information Program of the Latin American Association of Development Financing Institutions (ALIDE) (Lima, Peru).

### **Presentations**

17. Mr. Daniel Titelman spoke about “The evolving Role of National Development Banks,” commenting that great progress has been made over the past 10 or 15 years. Now we are talking about what the role of development banks should be and how we can enhance it, while in the past the discussion centered on how many of these banks could be closed and how quickly this could be accomplished. In this connection, he drew attention to the significant progress that has been made in recognizing the importance of NDBs and the role they can play in supporting economic growth and development in a region where, on average, the financial markets are not very deep and are little developed. Production is extremely heterogeneous and the demand for loans from the financial market also varies enormously. This heterogeneity calls for a wide variety of instruments to meet these demands. The challenge this raises is important because it has not been possible to develop the many financial instruments needed to manage the risk and heterogeneity of the different production agents. All of this varies from country-to-country, of

course, and as a result, the role of NDBs (and of their instruments) is closely linked to the relative development of the countries' financial markets.

18. As for the context in which the region's NDBs operate, Mr. Titelman commented that it is subject to economic cycles and is highly sensitive to external shocks, particularly those associated with capital flows and terms of trade, making economic growth in Latin America extremely volatile. In the 1990s, economic growth was generally closely linked to the financial flows of capital markets, in a relationship that was disrupted in 2004-2005, when growth in the region no longer correlated with the entry of capital flows, but with the terms of trade, which were highly positive. It is not easy to develop financial/capital markets in a context of high economic and macroeconomic volatility. In other words, the economic volatility has made it difficult for the market or the financial systems to develop spontaneously. The basic question to be asked is how can financial markets be promoted in volatile contexts, while the volatility is being reduced? For Mr. Titelman, it is here that NDBs are needed, for their role is closely linked to deepening the development of financial markets. The instrument they will use and the role they will play in the future will, therefore, depend upon just how developed and how deep the national financial markets are, in a context in which financial markets have tended to magnify economic cycles, rather than lessen their impact --in other words, they have overreacted to the cycles and have been unable to absorb the shocks. They have also shown serious shortcomings in confronting financial demands, for although banks normally have certain economic agent prototypes, their wide variety makes risk evaluation difficult and financing consequently more expensive. This is another field where NDBs could operate. But promoting access to financing does not mean merely granting loans, but also providing financial services to the different economic agents through the various instruments that permit appropriate risk management. In other words, it is not merely a problem of access to credit, but also of access to the financial system and to financial services; for that reason, the role of NDBs is closely linked to the relative development of the financial markets in which they operate.
19. Mr. Titelman mentioned that even after a decade of reforms, Latin America continues to have financial markets that are little developed, not very deep, and short-term, and where loan rationing is particularly noticeable for SMEs and innovative activities. Normally, systems with high and segmented financial costs and where access to the capital market for medium- and long-term financing is at rates that are more reasonable than those of the banking system, are fairly restricted to large enterprises. Generally speaking, bank use is very limited among a significant percentage of the population, at either the level of individuals or SMEs, which have little access to banking services. The situation is similar in the GDP share market, where capital markets are little developed, except in a very few countries, and the fairly low monetary turnover is indicative of markets illiquidity. The key question that arises here is how can market liquidity be increased? Entrepreneurship development surveys reveal that the main problem faced by entrepreneurs is access to financing or the capacity to finance their ideas. This is a problem that is far more serious than others affecting countries in our region: inflation, political instability, exchange problems, crime, infrastructure, competition problems, corruption, etc. Access to financing, then, by impeding or failing to facilitate business undertakings, becomes a highly important variable. Once again, we have a serious problem of access and not only to resources, but also at costs that are sustainable and viable over time. In general, there is no access to financial services that promote entrepreneurship development.
20. Mr. Ernani Torres' presentation dealt with "The Role of the State and of its Institutions in Counter-Cyclical Policies." Loan conditions directly affect the decisions of economic agents and even more so when they must be certain that the cash flow will be continuous and stable, guaranteeing that the project will not be interrupted, because the risk of project stoppage is too costly. Sudden interruptions of a country's loan flows affect the GDP and national income levels directly. In Latin America, credit is synonymous with banks; capital markets are still not

important as loan intermediaries. In Brazil itself, long-term credit markets are not important, because 90% of the loans are made by the banking system. Therefore, banks have to manage several types of risk simultaneously (loan, interest rate, term, etc.), with the result that the system is generally heavily regulated. At the same time, however, its specificity places the banking system in a highly procyclical situation. When the economy flourishes, banks ask for less guarantees and provisions and positive expectations push credit growth above economic growth. But when the economic situation is bad, banks have a tendency to be conservative and to reduce their lending activity to below economic growth. This is a characteristic that is almost never lacking in financial systems that depend upon banks, where the procyclical nature is stronger than in systems where capital markets are more important. This means that it is not a question of market failure, but of a structural situation. It must be stressed here that the availability of credit is very important for growth. But, at the same time, competition within the financial system fuels the procyclical nature of credit. In this sense, public banks are called upon to play a counter-cyclical role, in addition to filling the gap left by commercial banks. The BNDES can do this because its portfolio is, in fact, larger than that of the IDB itself.

21. Mr. Ernani commented, with regard to the BNDES in particular, that it is a very large bank in international terms, accounting for approximately 20% of the credit for the private sector, has a loan-to-GDP ratio of 30 to 31% and focuses on long-term financing. It was originally an industrial and infrastructure bank, but today also operates in the foreign trade and agricultural sectors. The BNDES has something to do with almost all investment activity in Brazil, except for that relating to the operations of enterprises that are highly internationalized and that, as a result, enjoy natural hedging or are able to obtain much cheaper financing. The BNDES acts as both a retail and a wholesale bank because, according to the Bank's vision, the role of retail bank is essential for a development bank, because of its need to seize and work out the risk directly with the enterprises and to make use of all of the financial techniques the market permits. Its regulatory framework allows the Bank to carry out operations of all kinds in the stock, credit, debenture and other markets. The fact that its operations are conducted mainly in local currency is very important in the infrastructure area, where investments require local currency hedging. The same holds true for industrial investments that are not export-oriented. The important role played by BNDES can also be seen in situations like that of 2002–2003 when there was a heavy capital outflow for purely domestic reasons. The exchange rate practically doubled, the credit system immediately retracted, and loans were in very short supply over the period. Even so, the Bank was able to maintain its share of the market, demonstrating its counter-cyclical role. During the crisis, the ratio of BNDES loans to private loans rose to 25%, not because it wanted to compete with the market but, on the contrary, because of the contraction of the rest of the market. At that time, the Bank also supported export companies whose credit lines were cancelled by foreign banks. Another important step it took was to support some highly important firms that were bankrupted because of heavy borrowing in dollars without adequate exchange coverage. The Bank entered those enterprises and rescued them by providing convertible debentures at very low rates.
22. Mauro Sartori, the Planning and Risk Manager of Banco de Comercio Exterior de Colombia S.A. (BANCOLDEX), in his presentation on "Financing and Promotion of Small and Medium Export Businesses" commented that in 2003 the Bank underwent a major change both because it was forced to take over the Instituto de Fomento Industrial (IFI), a wholesale institution responsible for entrepreneurial financing, and because of an alteration of the environment due to changes in the country and its negotiation of a Free Trade Agreement (FTA) with the United States. The first step was to clearly identify entrepreneurial needs. Then NDB best practices in the world were examined and it was found that economic changes create new needs and that in those circumstances NDBs turned to offering a variety of credit-complementary products like guarantees, insurance, factoring, information, business training, etc. The banks that were successful were found to offer products that provide overall support to enterprises and to have a

medium- and long-term vision. As a result of these findings, the institutional proposal that was designed for BANCOLDEX considered the provision of comprehensive solutions --in other words, as an NDB that offers multiproduct or multi-development banking solutions to modernize trade, industry and tourism, with emphasis on SMEs. It is also oriented toward supporting foreign trade, providing international banking operation services, document discounting, factoring, guarantees and insurance to facilitate access to financing, and structured treasury products. Exchange coverage and interest rate products are now under development.

23. As explained by Mr. Sartori, it is clear to the Bank that: (a) it is not as question of merely providing productive infrastructure, but also of improving the competitive structure of the businesses themselves: and (b) the problem with SMEs is not credit or its cost, but mainly their access to it. The Bank recognizes, however, that access to credit conceals far more serious problems, such as, for example, the fact that small entrepreneurs have no business training. For that reason, it was considered necessary to provide a structure that would facilitate business training, and agreements were made with universities and chambers of commerce; international cooperation was sought; and work was started on designing products that would combine financing with business training. In 2005, the Bank trained 11 thousand entrepreneurs and financial intermediaries in the use of its financing lines and services. Furthermore, due to its takeover of the IFI, the Bank started to support the development of cooperative models by training the executives of non-governmental organizations (NGOs) and cooperatives in order to increase the use of microcredit, which is still undeveloped in Colombia, because it is a vehicle for building the social fabric and making the productive system a bank user. In order to guarantee their competitiveness, enterprises are being organized into production chains, clusters and other associative systems that will improve the supply chains and reduce costs. As for its commitment to develop infrastructure that will add to competitiveness, the Bank is supporting the execution of local highway and port infrastructure projects. In short, BANCOLDEX's experience has been oriented toward filling the gaps left by the market, supplementing the efforts of the local banking system, maximizing local coverage and penetration of the market, and optimizing its service. All of this has been carried out with a medium- and long-term vocation, recognizing that there are no exclusive models, that continuous benchmarking and the appropriate identification of private banking needs are necessary, and that the work of NDBs should be accomplished under principles of financial sustainability and organizational efficiency.

## **Discussion**

24. Different viewpoints were expressed during the Meeting, among them:
- One point that was discussed concerned development banking and political cycles. It was stressed that one way for a bank to protect itself from or to manage cycles, particularly political cycles, is: (1) to have a suitable corporate governance system and (2) to take proper advantage of the requirements of the regulations themselves. For example, approaching the standards of the Basle Regulations will make it possible to manage portfolio allocations with complete transparency and will facilitate adequate risk selection, despite the possible existence of political interest.
  - Another point that was discussed was how procyclical or counter-cyclical a development bank can be and the development of early warning mechanisms to prevent the contraction or expansion of economic cycles. The capacity of NDBs to act counter-cyclically will depend upon the mechanism or instrument they are able to invent as an automatic stabilizer. The use of GDP-indexed bonds was an interesting proposal in this connection. NDBs could also collaborate with each other in order to generate flows that would produce greater stability. These would have to do with long-term compensation, because in the case of intra-Latin

American trade, ALADI has a short-term compensation mechanism in play. There is no equivalent for longer-term loans, however; central banks do not provide long-term financing because their reserves are used to handle short-term situations and for that reason they do not want to commit themselves for 10 or 15 years. NDBs, on the other hand, have a long-term vocation, which offers a margin for a kind of parallel compensation mechanism similar to that of central banks for the short term. This would make it possible for more expeditious financing of mutual exports.

- It was also commented with regard to the previous point that it is important: (1) for internal banking decisions to be highly transparent, so that what is happening within the organization is known, thus reducing the pressure on the Board of Directors or brought to bear by politicians; (2) to have external controls over the executive, judicial and legislative powers and that these controls be exercised through special bodies that are completely independent; (3) to have a mechanism that will ensure the full autonomy of bank personnel; and (4) for banks to have appropriate risk control mechanisms. Although in many cases NDBs are supervised in accordance with the Basle Standards, it should be understood that there is a need for long-term risk management different from that of the short-term risks covered by those standards.
  - As for NDBs and the role of the state in the financial system, in some countries, particularly those where the development banking system was almost entirely eliminated, there is a certain degree of mistrust over how those institutions can be managed. Even so, despite the fact that no institutional structure has been maintained from the perspective of the integration of both the state and NDBs and that there are a variety of development banking models in the region, it is possible to learn from the different experiences. The wide heterogeneity of production systems, inequitable distribution of wealth, and poor development of productive forces in the Latin American countries require the state's presence to spur the economic development of the most backward areas. It is in these aspects that NDBs should play a key role.
25. Mr. Romy Calderón, Head of ALIDE Economic Studies and Information, in his presentation entitled "International Financing, Public Policy and Development Banking Evolution," pointed out that in the first place a common denominator in developing countries, and particularly in Latin America, as to why NDBs emerge is the absence or little development of capital markets that satisfy investment requirements --in other words, for medium- and long-term financing. In order to fill this gap, the need arose for a specialized system to intermediate medium- and long-term resources and facilitate the extra-banking services that are not covered by traditional commercial banking. In the second place, that the financing flows to which the region had access at different times closely determined the orientation, and often the design and action, of NDBs. In the 1950s and 60s, NDBs obtained their funding for the most part from government resources and multinational financial organizations; in the 1970s, their access to international commercial credit was foremost; in the 1980s, the shortage of official and private resources forced NDBs to turn to innovative formulas, but also led to bankruptcies, as well as to mergers with other institutions that occasionally turned them into the development portfolios of commercial banks; and in the 1990s a new conception emerged in the context of financial reforms brought on by financial liberalization policies, one that still exists today, but with a more reflexive and less dogmatic attitude. In the third place, there is empirical evidence that public financial institutions have an important counter-cyclical role to play in credit flows, because they react less strongly to macroeconomic shocks than private agents. Examples can be seen in Argentina's recession of 1999-2000, when the loan portfolios of public banks increased as the credit offered by private banks dried up; in 1999, the worst year of Colombia's most recent crisis, while private bank loans dropped by (-4%), those of the public banking system increased (12% );

in Ecuador, during the crisis years of 1998 - 1999 and 2000, the loan portfolio of public banks showed growth of 11% and (-11%), while that of private banks declined (-8%) and (-80%); and in Mexico, the recession of 2001 and slight recovery of 2002 were mirrored in private banking loans, while the development banking system continued to inject credit up until 2003, when the growth trend became stronger.

### **SESSION III: FILLING THE GAPS: FUNCTIONS AND INSTRUMENTS OF NATIONAL DEVELOPMENT BANKS**

The chairman/moderator of this session was Mr. Daniel Schydrowsky, President of the Corporación Financiera de Desarrollo (COFIDE), (Lima, Peru) and the keynote speaker was Mr. Gonzalo Rivas, Past President of ALIDE. The panelists were Messrs. William Hayden, General Manager of the Banco Nacional de Costa Rica, (San Jose, Costa Rica); Cristián Palma Arancibia, Financial Intermediation Manager of the Corporación de Fomento de la Producción (CORFO), (Santiago, Chile); and Mauricio Cabrera, Director of Cabrera & Bedoya, Banqueros de Inversión, (Bogotá, Colombia).

#### **Presentations**

26. Mr. Gonzalo Rivas, in his presentation “Thoughts about Development Banking: Functions and Instruments” spoke about new things NDBs are doing in the different countries. He started off by asking himself what is the challenge in development banking? To his way of thinking, the challenge lies in reaching a balance between doing something that is important and doing something that is sustainable. NDBs in the past, sometimes too populist or too headstrong, started off doing things that could not be sustained over time. As a result, the pendulum moved in the other direction and emphasis was placed on sustainability and on how to make these institutions behave. The risk here is the possibility of becoming irrelevant --in other words, having very well-managed institutions whose impact is almost nil. The question then is how can we harmonize an institution that has something to say and do with the fact of its sustainability? A series of criteria for good NDBs have emerged in recent years, such as: (1) being concerned about institutional governance; (2) incorporating financial sustainability among their objectives; (3) having clearly-defined and transparent subsidies; and (4) having targeted action with a very clear definition of what the problems are. He pointed out, however, that after being concerned about macroeconomic stability for a long time, the economy of the productive sector has become important. There is also the challenge of producing more competitive economies that add value and create new sources of wealth --in other words, the challenge of increasing investment, generating innovation and keeping the gaps in innovation and knowledge between our countries and developing countries from widening. There is also the challenge of creating institutions that are capable of leading our economies in this direction. There are two very important roles NDBs can assume in this connection. One is to create financial instruments and the other is to take advantage of them as institutions. Given the wide variety of situations and realities in Latin America, the challenges for NDBs are not homogeneous, but vary widely and differ from one country to the next. It should also be stressed that there are no magic models. In the 1990s, it was said that all NDBs should become wholesale banks, but this is not so true because retail banks exist that have functioned very well.
27. Insofar as the banks’ roles are concerned, Mr. Rivas emphasized some that should be considered permanent in some way. In the case of retail banking, for example, the issue of territorial coverage has not been able to be resolved until today, except by retail banks. That is the case of Chile, an example of economic liberalization, which has a State Bank, one of whose main reasons for existing is that: (1) it ensures national coverage throughout the country, which has a huge impact on generating savings; (2) it has played a counter-cyclical and benchmarking role.

When the crisis emerged, followed by the recovery of private sector loans, interest rates continued to remain relatively high and what the Bank did was to offer sales promotions that gradually lowered the interest rate; (3) it provides long-term funds to institutions that operate in the microcredit sector. Often the market is not large enough to be able to offer SMEs long-term financing and the match that a NDB can offer is an added value; (4) by creating new kinds of instruments, it operates as a hidden subsidy to produce greater growth and development in our countries. The greatest challenge in the end is how to create financial instruments that will contribute to development and conceiving those instruments is an important role for NDBs. Examples of new instruments for market development are the complementary insurance created by the Banco del Estado, through which it offers not only loans to microenterprises, but also insurance against flooding and disease because the entrepreneur is the microenterprise's main asset and if he or she gets sick the loan will not be repaid. Another case is that of the Banco Multisectorial de Inversiones (BMI), of El Salvador, which is currently broadening the supply of available financial instruments and is boosting leasing, factoring, reciprocal guarantee companies and venture capital. A third case is that of the Banco Nacional de Costa Rica with its BN-Pymex program to promote small and medium exporters. The Bank identifies enterprises with an export potential and creates a series of alternative financial instruments for them, together with non-financial or entrepreneurship development services that will allow them to equip themselves as exporters. In the case of access to financial services, Mr. Rivas explained the experience of Banco de Ahorro Nacional y Servicios Financieros (BANSEFI), of Mexico, which acts as a sort of Superintendent that regulates and oversees small banks, which it serves as a kind of lender of the last resort. To sum up, NDBs have an increasingly larger role to play in generating financial instruments for the productive sector, which is part of their added value.

28. Fragile institutions due to excessive politicization is one of the characteristic weaknesses of Latin American economies. It is precisely for this reason that they do not offer their target public an unchanging profile and that, as a result, they do not have the capacity to be long-term institutions operating as instruments of public policy rather than of government policy, which is more temporary. For that reason, it is important to take advantage of the good group of professionals serving in the institutions. By way of example, the Banco de la Nación Argentina (BNA) is working with the Inter-American Development Bank on a loan for technological innovation in the form of a trust. The BNA was chosen precisely because of its financial expertise, which is expected to enable it to administer a trust of this kind. The IDB is taking advantage of NDB capillarity to reach different places. CORFO has been doing something similar for some time now. The Banco Multisectorial de Inversiones (BMI), of El Salvador, is interested in moving in that direction and there are other institutions that could do the same, taking advantage of the fact that they have highly qualified personnel, in order to meet a challenge that many others could not assume because they lack the necessary technical capacity. It should be stressed, as well, that one of the problems NDBs faced in Latin America was their attempt to resolve all situations, when in actual fact their instruments are limited; they can manage some instruments, but not all of them. The contribution these banks can make is important, but limited. The greatest success an NDB could have is for its efforts to become unnecessary --for it to be able to create the private market through leasing and factoring, as hoped. It is necessary to insert the efforts of NDBs within a broader strategic context that includes regulatory aspects and the supply of services for non-entrepreneurship development. Development banking should be conceived not only in terms of its limited niche, but also of the development challenge, in which those institutions represent a part of the solution, but are not the only variable involved.
29. Mr. William Hayden presented the topic "Financial Technologies to Improve Micro and SME Access to Credit." He explained that the BNCR is a public commercial bank that also functions as a development bank in the form of a multisector universal retail bank. It operates in all of the financial sectors through a stock brokerage firm, a pension fund operating company, and an investment bank and is on the verge of creating a trust company and a securitization company.

The Bank also provides microcredits to people who earn less than US\$ 100 a month. It does not receive State resources and 91% of its funding comes from third-party deposits, of which 45% are time deposits. Insofar as its Development Banking Program is concerned, Mr. Hayden explained that it is a Bank unit that offers financial and non-financial programs and services to micro, small and medium enterprise (MSME). The purpose of the Program is to channel loans on a timely and sufficient basis to sectors that have the capacity and potential to achieve greater efficiency and competitiveness, at interest rates that cover the financial and administrative costs and the level of credit risk, accompanied by complementary financial and non-financial services. This is carried out under the principles of the self-sustainability, profitability and efficiency of all Bank activities, the maintenance of a sound portfolio, optimum support, control and follow-up processes and the use of appropriate financial technology, under a strategy of growth while keeping its customer base. To accomplish this, it works along three lines: (1) retail banking that grants direct loans; (2) wholesale banking through cooperatives, mutual associations and NGOs; and (3) alliances with organizations for the purpose of adopting technologies, training, etc. In this way, the Bank seeks to give informal sectors and those excluded from society access to financial services and to make them a part of the economy. The Bank has created another program, complementary to the BN – Development Program, known as BN-Pymex, to support small and medium export businesses. It has been organized as a value chain, through which the international demand and the national supply are identified in order to take advantage of export opportunities and the enterprises are given financial and non-financial assistance and are monitored during the export process.

30. The reasons for the success of the BNCR Development Banking Program, according to Mr. Hayden, are the Bank's nationwide coverage that allows it to take advantage of economies of scale, personalized treatment of SMEs, provision of financial and non-financial advisory assistance, training, and entrepreneurship training, and financings at market interest rates with no element of subsidy whatsoever, almost all of this using public resources and, to a lesser extent, profit earned by the Bank through its various activities. The Bank's experience reflects two important things: (1) that NDBs can contribute to economic development using deposits of the general public --the saver public: and (2) that public commercial banks can carry out development banking activities under profitable and efficient conditions that are sustainable over time, thereby fulfilling a highly important economic development function for the country.
31. Mr. Cristián Palma, Financial Intermediation Manager of Corporación de Fomento de la Producción (CORFO), of Chile, addressed the topic of "Innovation and Financing for Entrepreneurship Development in CORFO" by commenting that the Corporation created an innovation fund about a year ago that has enabled it to organize a fairly massive support program for innovation and enterprise development from the incubation and launching stage to the expansion stage, involving not only credit but financing. During the initial stages, an important part of CORFO's support for innovation is provided in the form of nonreimbursable loans --in other words, of direct subsidies-- because Chile's experience with credit assistance has taught it to subsidize that which must be subsidized, and not to grant a loan that in the end turns out to be uncollectible. CORFO has a variety of programs for promoting business innovation and entrepreneurship development, the most important of which are the following:
  - ***Creation and strengthening of incubators:*** This program aims to create favorable conditions for the development of new enterprises and search for partners and markets, facilitate access to financing sources and build up the country's capacity for entrepreneurship. In order to avail themselves of the program, incubators have to be associated with universities, professional institutes and technical training centers. The assistance consists of a nonreimbursable subsidy granted in the form of cofinancing of up to 70% of the amount needed to create the incubator, with a ceiling figure of US\$ 600 thousand. For ongoing

incubators, the cofinancing amounts up to up 60%. The subsidy is intended to finance technological tours, the hiring and training of human resources, dissemination, investment and operating expenses.

- ***Preinvestment studies:*** This program is designed to reinforce the defining and formulation of new business projects through the cofinancing of start-up activities. The beneficiaries are individuals above the age of 18 and enterprises that have been in business for less than a year that propose the creation, start-up and launching of new undertakings. The assistance consists of a nonreimbursable subsidy in the form of cofinancing of up to 80% of the amount needed to carry out the proposed activities, with a maximum figure of US\$ 12 thousand. The subsidy is to be used to finance the sponsor's licensing expenses, market studies, business plans, enterprise start-up, commercial validation, surveys, and the cost of the guarantee.
- ***Enterprise start-up:*** By allocating subsidies to enterprises without any "currículum" that have innovative projects in the stages of creation, start-up and launching, this program promotes entrepreneurship. The support consists of a nonreimbursable subsidy provided in the form of cofinancing of up to 90% of the amount needed to execute the proposed activities, with a ceiling figure of US\$ 80 thousand. The subsidy finances the protection of the intellectual and industrial property, market studies, business plans, technical assistance, infrastructure adjustment or remodeling, rental of the premises, container design, preparation of manuals, certifications, trademark design, manufacture of samples, surveys, commercial validation, and distribution of the products or services, sales and management of the business.
- ***Support for technological business:*** This program promotes activities aimed at introducing into the market innovative products obtained from the execution of technological development and innovation projects. The assistance consists of a nonreimbursable subsidy provided as cofinancing of up to 70% of the amount required to carry out the proposed activities, with a maximum figure of US\$ 100 thousand. The subsidy finances the legal establishment of the enterprise, formalization of commercial alliances, protection of the intellectual and industrial property, market studies, business plans, container designs, manuals, certifications, manufacture of samples, surveys, commercial validation and advertising, infrastructure adjustment, sales and management of the business.
- ***Support for angel networks:*** This program supports the organization, formalization and operation of networks of angel investors who raise investments by segments of from US\$ 20 thousand to US\$ 500 thousand, in innovative enterprises with a large potential for growth. These networks must have a legal status and accredit the commitment of at least 20 investors with a joint equity of more than US\$ 14 million. The support consists of a nonreimbursable subsidy of up to 80% of the amount needed for the network's formation, with a ceiling figure of US\$ 360 thousand. The subsidy must be used within a period of no more than 3 years that may be renewed for a further 3 years, in accordance with the accomplishments, and is intended to finance the hiring and training of human resources, technological surveys, dissemination, investment and operating expenses.
- ***Seed venture capital:*** This program finances investment funds specialized in investing in small businesses no more than 3 years old that have innovative projects, with investments ranging from US\$ 100 thousand to US\$ 600 thousand per enterprise, in accordance with an identified angel capitalist. The investment funds apply to CORFO for financing amounting to up to three times their capital, which they will repay upon liquidation, within a period of no more than 15 years, at an interest rate commensurate with their profitability. Fund administrators are entitled to nonreimbursable subsidies for administrative expenses

amounting to US\$ 120 thousand the first year of operation and US\$ 24 thousand per investment made as of the second year, for a total of up to eight years, with a ceiling of 14 investments per year.

- ***Innovative venture capital funds:*** This program finances investment funds specialized in investing in small and medium-size businesses with equities of no less than US\$ 3.6 million before receiving fund assistance, and that execute innovative projects. Investment funds can apply to CORFO for financing amounting to three times their capital, which they will repay upon liquidation, within a period of no more than 15 years, at an interest rate subject to their profitability, amounting to between 2 and 5% of their profit per year, with a ceiling of 25% of the funds' profits.
32. Mauricio Cabrera, Director of Cabrera & Bedoya, Banqueros de Inversión, of Colombia, in his presentation, "Venture Capital and National Development Banks," stated that a key aspect of the promotion of economic and social development by NDBs, within the context of the search for equity as a development policy objective, is the construction of inclusive financial systems, strengthening of financial democracy and creation of opportunities for the majority. The traditional approach has been to increase the supply of financial services and resources through the mobilization of domestic and international savings, new long-term credit and financial instruments, specialized institutions and improvements in efficiency and governance. Little attention has been paid to the other side of the problem, which is the lack of demand for credit. It seems paradoxical that, on the one hand, there are large numbers of MSMEs that need loans, whose applications do not reach banks or are rejected because they are high risk, while on the other, the banking business seeks to lend money to those who can "show that they do not need it." There is a potential demand, but not a real one, because those wanting loans are not credit recipients. All financial engineering has been developed in terms of large enterprises. For that reason, inclusive financial systems need a series of instruments to develop credit recipients, such as, for example: an appropriate regulatory framework, guarantee funds, microentrepreneur training institutions, technical assistance and technological support agencies, national and international marketers, specialized (retail) lending entities, and venture capital funds (VCFs).
33. Insofar as the VCFs are concerned, Mr. Cabrera proposed their use as an instrument to make enterprises that lose their status of credit recipients because of a crisis reassume that status once again; and to exercise counter-cyclical action to keep credit flows from being interrupted. During crises, debtors lose their capacity to pay for macroeconomic reasons. The result is that they overborrow in terms of their income and equity. The traditional solution to this problem is to restructure the enterprises, cutting off the flow of new resources. This solution offsets the banking system's losses through either the requirement that the shareholders capitalize, support via public funds, or nationalization. In this way, the banks' equity is recovered (or they are liquidated), but the debtors' problem remains unresolved. The recession then worsens and the fiscal toll is high. Using VCFs, debtors are able to reduce their debt using the new capital resources and thereby recover their equity and capacity to pay. The remaining debt is then restructured, giving debtors access to fresh credit and making them credit recipients once again. The fiscal cost is lower because the treasury does not have to pay off the entire debt to avoid provisioning and loan losses. NDBs have an important role to play in promoting this instrument by developing specialized private professional managers.

#### **SESSION IV: ENHANCING THE EFFECTIVENESS OF NATIONAL DEVELOPMENT BANKS**

The session chairman/moderator was Mr. Ricardo Palma Valderrama, Special Representative of the Latin American Association of Development Financing Institutions (ALIDE), (Lima, Peru) and the

keynote speaker was Mr. Ramón Trías, Director General of Aplicaciones de Inteligencia Artificial (AIS), (Barcelona, Spain). The panelists were Messrs. Juan Carlos Tamayo Pino, Advisor to the General Management of Fideicomisos Instituidos en Relación con la Agricultura (FIRA)-Banco de México, (Morelia, Mexico) and Randall Dodd, Director of the Financial Policy Forum, (Washington D.C., USA).

## **Presentations**

34. Mr. Ramón Trías, Director General of Aplicaciones de Inteligencia Artificial (AIS), Spain, in his presentation, “Evaluating the Performance and Impact of Development Banking,” spoke about the ALIDE Index Project, which seeks to develop a theoretical framework and an instrument to evaluate the performance of development banking by defining specific indicators to evaluate profitability, financing and operating costs, and the fulfillment of the mandated efficiency aspects of the actions oriented toward the performance and impact of their banking activity. NDBs have traditionally been measured according to concepts similar to those used for commercial banking, when in actual fact their aims and objectives are totally different from those of private enterprise. The project seeks to develop an easily applicable methodology that will serve as a strategic management tool for the continuous optimization of national development banking and that will identify the weak points, together with benchmarks, in order to enhance the efforts and fulfill the objectives of those banks more satisfactorily. Despite this aim, Mr. Trías explained how difficult it is to design methodology that will take into account the wide diversity of NDBs in aspects like: differing viewpoints about development, priorities, method of operation, form of financing, etc. For that reason, he emphasized that NDBs and their activities cannot be summarized in a single number or index. As a result, the correct measurement of these financial institutions must necessarily be multidimensional. They can be divided partially into groups with similar means and objectives and the efficiency of their activity can be measured in terms of an “efficiency frontier,” with their distance from that frontier being a measure of their inefficiency. He then proposed making two different types of analyses: (1) an index of relative efficiency and (2) the efficiency frontier. Data Envelopment Analysis (DEA) would be used to identify best practices. This would be supplemented by the use of performance indicator families that would take up different aspects of national development banking action in more detail, in order to determine: (1) profile and behavior; (2) efficiency of actions; and (3) the impact of NDB actions on the country’s development. The indicators would make it possible to measure how closely aligned DFI activities are with a country’s development policy.
35. He went on to point out that in the future, this performance evaluation instrument could serve as a platform for developing three important lines of action to improve development banking: (1) The development of a rating body, inasmuch as an in-depth analysis of the information collected would make it possible to have a precise evaluation of NDBs parallel to the rating of rating agencies; (2) as a vehicle for improving governance and achieving better coordination between public policies and NDB orientation; and (3) the creation of information systems for risk control. The latter calls for specialized computer tools that could be developed and shared within the development banking community. Lastly, he indicated that by their very nature, NDBs are called upon to collaborate, and not compete, with each other; it is easy for development banks, unlike commercial banks, to capitalize on experiences, criteria and knowledge through exchanges and cooperation.
36. Juan Carlos Tamayo Pino, Advisor to the General Management of Fideicomisos Instituidos en Relación con la Agricultura (FIRA)-Banco de México, in his presentation on “Transparency and Corporate Governance in Development Banking,” commented that, in general, good corporate governance seeks to improve practices that benefit shareholders and interested parties in regard to: a) ensuring the rights and equitable treatment of (minority and controlling) shareholders; b) revealing adequate and timely information that is transparent; c) clearly defining the

responsibilities of the boards of directors and management (agency problem); and d) ensuring the rights of interested parties (stakeholders). For NDBs, on the other hand, the objectives and requirements are broader, to wit: a) guaranteeing long-term solvency in order to minimize the fiscal cost and the cost to the taxpayer (shareholder of the last resort); b) clearly defining the institution's mission and ensuring its fulfillment (avoiding unmandated actions); c) avoiding political interference; d) eliminating conflicts of interest with stakeholders; and e) guaranteeing a separation between the work of public and state property policy formulation. Boards of Directors tend to be a formal instrument. Their membership is generally large, making it difficult to deal expeditiously and in depth with the matters discussed. Furthermore, the general directors or presidents of Latin American development banks are usually appointed by the president of the country and not by the board of directors. Government representatives: a) because of their high level, in some cases, naturally tend to give priority to time and functions, to the detriment of their contribution to the institutions' management; b) the separation between the function of public policy-making and that of advisor is not very clearly defined in all cases; and c) they do not always have banking or financial expertise. The representatives of the stakeholders, for their part, tend to create conflicts of interest because they act more as managers than as advisers.

37. Mr. Tamayo commented that in the particular case of Mexico, significant advances have been made in the corporate governance of NDBs. The organizational laws of these financial institutions were recently amended to allow for independent advisers. Furthermore, Mexico's National Banking and Securities Commission issued prudential provisions on internal control, stipulating the design and operation of Auditing Committees. Institutions with 7 to 9 advisers now have one or two independent advisers. Some structural shortcomings continue to exist, however, as to the size, composition and operation of the boards of directors that limit good corporate governance. Even so, there are some easily implemented measures that could be taken in regard to the independent advisers in order to enhance corporate governance, such as: (1) increasing their number and proportion; (2) establishing a mechanism to guarantee better selection; (3) establishing a transparent, standard mechanism to determine their remuneration; and (4) their inclusion with a 2-year term that is renewable and their staggered replacement. NDBs in Mexico are generally moving toward better corporate governance practices that make it possible: (1) to adopt best international practices in this area; (2) eliminate presently existing conflicts of interest on boards of directors; (3) create professional bodies that make impartial professional decisions; (4) achieve transparency of information; (5) make the business more secure and reduce risks; and (6) ensure the fulfillment of the institutions' objectives. Improvements have been made in FIRA's corporate government in particular, among them: (1) independent members have been included on the asset and liability management and risk management committees; (2) in short, the technical committees (that operate as a management board) will also include independent members; (3) The Information Technologies Committee was set up with best practices in corporate governance; (4) an internal control system was instituted that will ensure compliance with institutional objectives, with best practices in banking; and (5) a Control and Audit Committee was formed which will progressively evolve toward an Audit Committee with the participation of independent advisers.
38. Mr. Randall Dodd, Director of The Financial Policy Forum in Washington D.C. made a presentation on "Development Banking Lessons in the United States." He pointed out that the general objectives of development finance institutions in the United States are to promote stable growth, sustainable development, more equality, and access to credit. To those ends, they are oriented, more specifically, toward long-term financing, particularly in remote areas and specific sectors, like agriculture, housing, loans to SMEs and microfinance institutions, seed capital for new and agricultural enterprises, and risk management services, among others. It serves these sectors with loan guarantees, insurance coverage and technical assistance. The NDBs are financed through: (1) securities issues: stocks and bonds; (2) loans from commercial banks and

local private financial institutions, the government or other NDBs, as well as from international private financial institutions; (3) grants; (4) government guarantees covering the private financing; and (5) retained guarantees. While these are public institutions fully owned and operated by the government, they are not government institutions *per se*. In effect, the government role is exercised by the membership of the Boards of Governors which is appointed by the President or the Governor. In this sense, it is the government that defines the institutions' mission. Their activities include: (1) granting loans to municipal or state governments, other NDBs, corporations, SMEs, agriculture and microfinance institutions; (2) direct loans, the purchase of the full or part of the portfolios of private entities, credit to private entities that use certain loans classified as collateral for the credit they receive (differs from the purchase of their portfolios because it does not include debt service, except in the case of default --they differ from direct loans because they are collateralized); (3) technical assistance; and (4) economic valuation and evaluation. It can be generally said with regard to the lessons United States development banks teach us that that they have helped: (1) provide credit in areas and sectors where it had been denied or the supply had been insufficient; (2) supply credit and seed capital during economic disasters in order to maintain the counter-cyclical economic policy more effectively; (3) create new products that offer solutions to longstanding problems of illiquidity and concentration on credit risk; and (4) supply direct credit flows to important sectors through subsidies and loan guarantees.

## **SESSION V: THE NATIONAL DEVELOPMENT BANKS IN THE FUTURE**

The chairman/moderator of this session was Mr. Rommel Acevedo, Secretary General of the Latin American Association of Development Financing Institutions (ALIDE) (Lima, Peru) and Mr. Antonio Carraro, Executive Director of the Brazilian Association of Development Financing Institutions (ABDE) (Rio de Janeiro, Brazil) was the keynote speaker. The panelists were Mr. Felipe Tami, Special Adviser to the Latin American Association of Development Financing Institutions (ALIDE) (Argentina), Mrs. Stephany Griffith-Jones, Professor at Sussex University (Sussex, United Kingdom) and Mr. Jan Kregel, Head of Financial Policy Analysis for Development, United Nations (New York, USA)

### **Presentations**

39. Mr. Antonio Carraro, Executive Director of the Brazilian Association of Development Financing Institutions (ABDE) emphasized in his presentation what NDBs can do to help economic policy manage development. He commented that the economic performance of the Latin American countries and particularly Brazil is characterized by low GDP growth rates, inequalities that have been maintained and have worsened in recent decades, low productivity and little competitiveness. He then went on to ask himself what elements of the financial market and of the credit supply can influence this performance? The most obvious one is the low density of the financial market, which is one of the causes of these three macroeconomic problems in our region. In Brazil's case, for example, he considered that the main credit problems stem from the investment financing structure. Total annual investment amounts to 18% of GDP, or about US\$ 54 thousand million (note: one thousand million is considered one billion in the United States). Of this amount, the BNDES contributes US\$ 20 thousand million, representing only 40% of the country's investment. Finance companies, for their part, finance 40% of the investment from their own resources. Therein lies the major problem, which is that 40% of the demand for financing has to be covered by financing using the enterprises' own funds. External savings, consisting of the deposits of large enterprises and many state enterprises, cover 10% of the investment and that opens the door to the entry of external volatility. Flows of external savings dry up immediately when there are problems in the international market and the terms of trade and fund-raising conditions worsen for the enterprises. In short, the capital market is extremely underdeveloped, and although it has improved in recent years with the adoption of the

convertible debentures scheme, it is still too marginal to finance investment in Brazil. The other public banks play a complementary role to that of the BNDES, operating with its same characteristics and engaging in counter-cyclical activities. BNDES financing and that of the public banking system in general are fairly stable and for that reason it is the private financial agents that react, not to changes in the real bases, but to their perception of the risk, that are responsible for propagating external instability in the country.

40. A second point that Mr. Carrazo made is that the problem affecting the countries' economic performance must be traced to the credit market, to the segment that has no access to financing, rather than to external volatility. There is a potential for economic growth that is currently not being realized because the investment financing profile is currently sub-optimum. Enlarging the access of enterprises to credit would help achieve this potential. Financing investments from their own capital is also sub-optimum; in Germany the ratio is 15% and the average for Europe is 20%. NDBs are called upon to act in this segment. The generic guidelines for improving the performance of the private financial sector do not necessarily reduce the problem of access. In Brazil, for example, the government altered some parameters to improve private market risks in granting loans. As a result, there was an improvement in the loans-to-GDP ratio of from 25% in 2002 to 35% in 2006. If we analyze the case in detail, however, we will find that 100% of that growth can be attributed to an increase in consumer loans to pensioners and retirees equal to the discount permitted by the government in monthly payrolls (with zero risk). Although consumer credit was increased, the country's productive capacity remained unchanged. This is obviously not the kind of credit that is needed because it does not expand productive capacity. According to Mr. Carraro, the task of NDBs in Brazil at the service of public policy is to tackle the problem of access to credit by the 40% of the population that lacks it. To sum up, he considered that the main problems of the financial market are, in order of importance: a) access to credit; b) the cost of credit; and c) the volatility of the credit supply. For that reason, he feels that the most important activity of development banks is to promote access to credit by the segment that lacks it. Reducing volatility, on the other hand, is a task that should be left to macroeconomic stabilization policy. NDBs cannot be asked to collaborate in this undertaking, even if by fulfilling their mission they will help to bring down volatility, for the Asian crisis is known to have been due to the quality of the loan portfolio. In other words, the mission of NDBs should target access to credit.
41. As for the lines of action that NDBs should undertake, Mr. Carrazo summarized them as "everything that will help overcome the asymmetry of information, which could be considered a first best." As specific actions, he emphasized the development of the private market and of new instruments for or new ways to manage risks; the application of securitization and of standardized products (with wide coverage); and emphasizing cost reduction. To his way of thinking, all efforts should aim to overcome or alleviate the asymmetry of information; it is from this that concrete lines of action for NDBs emerge. In this connection, he considered that the most effective means are guarantee systems, of which he pointed out two that could be simultaneously pursued. (1) The first are guarantee funds that represent a second best because they do not reduce information asymmetry, inasmuch as the funds or programs leave the project analyses up to the financial agents. As a result, the financial agent has no incentive to overcome the problem of the lack of information, particularly when the guarantee funds involved are public funds, in which case some disadvantages continue to exist, such as moral risk and adverse selection. The great advantage, on the other hand, is the speed with which it can be put into operation and thereby permit access to credit; and (2) the first best is the European mutualist experience with Reciprocal Guarantee Societies (RGSs) because these do confront the asymmetry of information. Under mutualist management, the beneficiaries of the guarantee have to pay a small part of the capital in the RGSs; furthermore, the projects are analyzed by the society, while private banking only grants the loan. The information, therefore, is worked on within the RGS, during which its asymmetry is surmounted. The disadvantage is the slowness of

its implementation and its dependence on a favorable environment. In Italy, it took 50 years to learn its effects, which are considerable.

42. Mr. Felipe Tami, ALIDE Special Adviser, presented a general vision of development banking and its future challenges. He mentioned that in recent literature, there is a noticeable re-legitimization of development banking functions and in this regard stressed that it is an institution's function, not its format, that is decisive. A number of different formats can exist -- there is no universal truth here--, but what is important is a correspondence between format and function. He commented, with regard to the characteristics of financial markets, and particularly their volatility, that credit is scarce and expensive and that capital markets are unstable. The fact that the bulk of the financing that is not generated by the enterprise's own resources comes from banks is indicative of a problem, because it is the capital market and not banks that should channel long-term financing. Insofar as the best practices that have emerged in development banks are concerned, he underscored the widespread proliferation of instruments, incorporation of technology, and modernization in the fulfillment of their mission. The incorporation of financial technology, in particular, has had significant results in many cases. Complementarity was another aspect he stressed. The age-old discussion about development banking versus commercial banking has become outmoded, as has the sterile distinction between state and market, because the solution involves both actors, including social actors that have become better recognized as the emerging actors of civil society, NGOs, etc.
43. Mr. Tami concluded by pointing out the need for correspondence between characteristics and action, insofar as the environment and development policies are concerned. In this connection, in speaking about a financing system for development, development banking is included in a function for which it is intended, but there is also a need for the integration of development banks and commercial banks, capital markets and other financial and civil society agents. This means having a larger vocation for cooperation in the exchange of experiences and the preparation of joint and coordinated activities among the banks, in order to take advantage of combined efforts. Financial and public policies are generally not implemented (or are not born) in a vacuum, but within a certain context and their nature varies according to the specific reality, but what they all share in particular is the need to undergo a certain gestation process. It is very important for NDB performance for policies to be clearly defined in terms of their objectives, roles, etc. It is true --and this has been pointed out endlessly-- that NDBs must carry out their activities free from political interference and must maintain the quality of their technical and administrative personnel, who must be permanent staff and subject to accountability. This is closely tied in with the environment and, in this case, the reason why NDBs are sometimes deficient (from the government standpoint) is due to the impact of external elements. Particularly if we consider the predominantly public nature of many development banks in the region, the quality of the development policies and the subject of quality management of development banking are a complementary and reciprocally linked problem.
44. Mrs. Stephany Griffith-Jones, Professor at Sussex University in England, proposed the use of a GDP or growth-indexed bond to moderate the procyclical nature of credit. This is a type of bond whose amortization is tied to a country's growth level. If the country grows more, it pays more, and if it grows less, the weight of the debt service is reduced; in this way, it plays a stabilizing role in financing cycles. The benefit of this instrument for the countries is that governments can stabilize their spending and therefore offer a larger fiscal space to offset the counter-cyclical effects that would otherwise be amplified, to the detriment of economic performance. It also reduces the probability of defaults and debt crises. Its use is not limited to a specific type of country, but could benefit both emerging and developed countries. It offers investors a chance to participate in the countries' economic growth and the possibility of diversifying their portfolios and the more countries that issue bonds of this kind, the greater the possibility for diversification. They will also benefit from the reduced probability of crises brought on by costly losses. In

short, instruments of this kind create positive externalities for both investors and countries and their benefits justify taking public action to develop them. The latter is particularly important because financial markets, although they appear to be innovative, are in actual fact quite conservative. In this connection, Mrs. Griffith-Jones proposed that ALIDE encourage this type of financing. An important aspect to be considered is that the more issuers there are, the less the risks and, hence, the costs. Therein lie the advantages of broadly promoting the use of this instrument. Multinational banks like the World Bank can act as market makers by buying the bonds, thus making it possible to finance the issuer countries. NDBs, for their part, can act as both issuers and sellers of the bonds to multinational institutions. The main problem of this instrument is that it does not yet exist. The extreme volatility in Latin America, however, makes the need to develop these bonds obvious.

45. Mr. Jan Kregel, Head of Financial Policy Analysis for Development at the United Nations, in his presentation "Building Domestic Financial Markets to Stabilize Capital Flows," proposed some new lines of action for NDBs, to create financial markets that may be used to change the direction of national capital flows, for example, trying to direct the flows toward the private sector or to channel international flows toward the financing of government projects; this could normally be done through domestic or national markets, based on the premise that the function of the financial sector is to back the investments of the private sector. One of the problems Latin America has been facing, particularly since the crisis of the 1980s and of the ensuing structural adjustments, however, is that the systems do not appear to be aimed at backing the private sector or private investments. The central banks, by establishing inflation targets, do a little something in this direction. What the inflation target does is create differences in interest rate and these differentials produce arbitration flows. This arbitration process should presumably eliminate these differentials or take them to an equitable point. However, if the inflation or arbitration objective is not eliminated, it may become permanent and touch off flows that will tend to distort not only the domestic interest rate, but also the exchange rate. They do not produce virtually any benefit and, on the contrary, they make it difficult for countries to compete in international markets precisely because of their exchange rate valuation. He also recommended to the governments of the emerging markets to replace their foreign currency funds with local financing. A number of developing countries have done this very successfully, reducing mismatch and instability. The fact is that the balance sheet of the national banking system is the destination of most of these funds.
46. Mr. Kregel went on to comment that Latin America's situation is similar to that of the United States in the 1960s, when commercial banks stopped financing businesses because government securities offered better returns. This situation started when commercial enterprises that had bank deposits decided to trade them for treasury notes that were more profitable, because the interest rates on deposits were regulated. Since current account deposits earned zero interest, large companies simply left the banking system. Left without deposits, the banks stopped lending and the result was the creation of a system of commercial loans in which the banking system played no direct part in financing business. Commercial firms offered short-term loans and held treasury notes. CITIBANK invented something it called a negotiable certificate of deposit that paid interest but was not under the control of the Federal Reserve System. This gave rise to a system in which medium-sized businesses could grant commercial loans that were kept afloat by what was called the money market. The lack of bank financing was also replaced by a system very akin to securitization. A vehicle was created, as well, the short-term capital market investment fund, whose risk was relatively low because of its large diversification. This solution, particularly in the United States, was boosted by the regulation of deposits and rested on the higher rates of return earned on short-term investments with the general public. These regulations no longer exist in most Latin American countries, so there is no pressure on banks to adopt this solution. It arose as a possibility for creating new types of financing that could channel foreign investment into SME financing, such as, for example, that NDBs could establish

the equivalent of investment funds in the money market, where they could take short-term loans to SMEs and package them into investment funds that could be sold to foreign international investors.

## Discussion

47. A number of different viewpoints were expressed during the session, among them the following:

- A first point that was raised was how to link the market for commercial paper with loans to small and medium enterprises, because there are probably investors in international capital markets for whom buying paper in small and medium Latin American enterprises could look attractive because these correlate negatively with their portfolios. What isn't clear is whether investors are sure about how to collect their earnings. For that reason, it was felt that there should be middlemen who would guarantee their payment if investors were unable to collect what they were owed. This is an investment banking task for NDBs.

Other problems in selling the securities of small and medium enterprises were stressed, as well. For example, it was mentioned that although Brazil has a very large potential because of the lack of depth of the private financial system, the exchange risk problem is very pronounced at this moment due to the overvaluing of the Real and it appears likely that the problem will continue to exist for quite some time, as a result of the performance of the balance of payments and balance of trade. This could perhaps be applicable to companies that have a natural hedge --that is, to medium-size exporters-- that would allow them to neutralize the exchange risk without further risk. Another alternative could be to create this market for pension funds, which are capitalized very rapidly. The funds would be natural buyers of these securities and large NDBs could participate as guarantors of the securities.

- A second point that was discussed concerned the proper percentage of private sector investment in a project's financing. According to one opinion, the ideal formula is 60% bank financing and 40% provided by the enterprise; this would make a project bankable and there would be less risk because businessmen would have to supply an important percentage of their own resources; experience has shown that if 100% of a project is financed, the entrepreneur will not be concerned about it. A different opinion is that the entrepreneur could maximize his or her leveraging power and that the international standard is normally that the business contribute 20 or 25% to a project's financing.
- Another point that was raised was how can banking regulation, above all Basle II, work against more systematic and forceful development banking action?, when that regulation requires a larger coefficient of capitalization by these institutions making it harder to grant larger loans and, furthermore, guarantees are demanded from other sectors. It was pointed out in this regard that: (1) it is not clear what effects that regulation will have on the Latin American banking system. A concentration of the market is foreseen, for the simple reason that it will be more difficult for small banks to adopt risk management systems that are highly sophisticated and costly. This will reduce competition among the banks and increase the cost of capital. If today there is little incentive to seek information, with Basle II there will be even less, but if NDBs could offer ways to overcome the problem of information asymmetry --which is necessary for the new valuation of risks-- , they could get private banks to increase their credit offer without incurring further risks and costs. In other words, it is possible to neutralize market concentration that could result in credit restriction and an increase in costs, through the complementary action of NDBs in offering additional guarantees and information at no cost to those banks; (2) much depends on how the NDBs are financed. If their funds are raised directly from the public for the purpose of

intermediating loans, the banks will have to abide by the parameters of Basle I and II; but if their funds are provided by the State for certain directed programs, their treatment will be different. For that reason, it was proposed that thought be given to regulations for development banking that would depend upon the nature of the funding, in which the important points would be the recovery of the loans and that the program be self-sustainable; and (3) the Basle Standards have incorrect instructions for lending to developing countries, whose risks do not always correlate with those of developed countries. Failing to take account of this benefit from diversification is a technical mistake and discriminates against the developing countries. Latin America should try to get Basle to recognize this problem. Some econometric estimates of Basle's impact on Brazil and Argentina reveal a net decline in economic growth because of the tightening of credit.

## **SESSION VI: CLOSING OF THE MEETING, CONCLUSIONS AND ACTIONS FOR THE FUTURE**

48. The session was chaired by Mr. Rommel Acevedo, Secretary General of the Latin American Association of Development Financing Institutions (ALIDE), who, on behalf of the ALIDE General Secretariat, warmly thanked the speakers and panelists and emphasized the international presence of institutions from not only Latin America, but also from outside the region and reaffirmed ALIDE's commitment to continue collaborating with the United Nations on this Regional Consultations initiative.
49. Mr. Daniel Schydrowsky, President of the Corporación Financiera de Desarrollo S.A. (COFIDE), of Peru, then thanked the United Nations and ALIDE for their role of catalyst and promoter of meetings like the Consultation, which had proven to be very fruitful. He went on to state that extremely interesting concepts and ideas had been expressed at the meeting. He then recalled that he had had the opportunity to be in South Africa in the 1990s and to learn about the experiences of the Industrial Development Corporation and the South African Development Bank, which are facing problems very much like those of Latin America with extraordinary similarities and explained that perhaps the subject matter taken up at the meeting could be useful to the two institutions, which were present. He added that this would constitute a framework for South-South cooperation that is not being taken advantage of and that we could learn from each other.
50. Mr. Romy Calderón, Head of Economic Studies and Information of the Latin American Association of Development Financing Institutions (ALIDE), commented that there had been an excellent exchange of experiences and best practices during the meeting, with the presence of experts from more than 10 countries of the region and international organizations, together with extraregional institutions, that had allowed for a cross-fertilization of knowledge. He then briefly summarized the most important aspects of the meeting, emphasizing: (1) the recognition that there is no single development banking model and that the model each country adopts will depend upon its own particular conditions and needs; (2) that NDBs, regardless of their public or private nature, fulfill public, social and service functions which, as such, should be enhanced, technified and given a sound grounding. NDBs should play a leadership role and a complementary, but innovative and pioneering, role; (4) subsidies can be granted if necessary for activities or undertakings that require public action, but they should be duly budgeted and clearly transparent; (5) a subject that is considered especially important is the need for NDBs to build up their cooperation with multinational development banking in order to diversify (decrease) the risk more efficiently and facilitate resource mobilization. This cooperation can add significantly to the effectiveness of financial intermediation through long-term instruments, guarantee funds, securitization and venture capital; (6) the financing problem is not one of cost or the lack of resources, but of access, particularly by small and medium enterprises; (7) by acting counter-cyclically in the financial market, NDBs play an important role in lessening the impact of

economic cycles ; (8) NDBs should act as instruments of public policy, not government policy, and should be part of an array of economic policy instruments, in which they have a specific function, and not seek to do too many things at once time that end up distorting their function.

51. In the institutional terrain, Mr. Calderón mentioned the appreciation expressed to the United Nations for its part in leading the process to rethink the role of NDBs in the twenty-first century. He stressed the statements that the United Nations should contribute to building up the regional associations like ALIDE by: (1) Creating a “think tank” to continue the discussions, deal with technical research and formulate proposals about the NDBs and the financing of socially inclusive development; (2) endowing/assigning permanent and temporary experts to work with ALIDE and with other regional associations; (3) disseminating information about their programs and projects, as well as the results of their activities, including support for their virtual systems; and (4) continue promoting interregional exchanges between the associations and NDBs from the different regions, as well as the strengthening of their global body, the World Federation of Development Financing Institutions (WFDI) and exchanges with institutions and NDBs in industrialized countries.
52. Mr. Ricardo Espina, Economic Affairs Officer, Financing for Development Office, United Nations Department of Economic and Social Affairs, also thanked all of the speakers and participants who were present throughout the meeting. He expressed the organization’s appreciation to COFIDE and to ALIDE for their valuable support in organizing the Consultation. He went on to explain that the International Conference on Financing for Development, which resulted in the Monterrey Consensus, gave the United Nations Office of Economic and Social Affairs the mandate to organize seminars and stakeholder consultations with the participation of experts from the official and private sectors to examine technical issues connected with the mobilization of resources to fund development and eradicate poverty and exchange information and best practices. In response to this mandate, during the 2004-2005 period, the Financing for Development Office co-organized 21 events in 15 cities over the world with about 500 participants. The issues addressed were inclusive financing, sovereign debt and public private partnerships (PPPs) to improve development assistance, among other things. It is in this framework that the United Nations is conducting regional consultations about NDBs, given the importance of these institutions for boosting the countries’ economic growth.
53. Mr. Espina emphasized that the subject that had been chosen for these consultations was how to improve the role of development banks in promoting economic and social development and what to do to give them a greater contribution? He explained that the idea was not for the First Regional Consultation to produce final conclusions, but to share experiences and best practices and find out what functions and what doesn’t in what context. What’s more important, it is one meeting of a process that was started in New York in December 2005, where the topics to be included in the consultations were defined. He then stated that this first consultation will be followed by another in Paris, France, on June 27 and 28, co-organized with the French Development Agency, the Kreditanstalt für Wiederaufbau (KfW), of Germany, and the European Investment Bank (EIB). Another meeting will take place in Africa with the Industrial Development Corporation and further meetings will be held in Egypt, India and possibly Eastern Europe. The first round of regional consultations should come to an end around the first quarter of 2007, and a final meeting is planned at the Kenndy School at Harvard University, sponsored by the Center for International Development. At that point, all of the knowledge that is being collected at these meetings throughout the world will end up in a publication that will serve development banking and will also be presented to the United Nations General Assembly. Subsequently, we may delve into more critical issues and continue with a second round of consultations.