48 ALIDE GENERAL ASSEMBLY LIMA, PERU-2018

“Development Banking, Challenges of the Present and Challenges of the Future”

CONCLUSIONS AND RECOMMENDATIONS

- **Economic growth** is recovering and recovery is more synchronized throughout the world. It is estimated that the world economy will grow in 2018 and 2019 by 3.9%, a figure close to 3.8% in 2017. Regarding Latin America and the Caribbean (LAC), an expansion of 2% is expected for this year and 2.8% by 2019. However, the proximity of the electoral processes in some countries, the aging of the population and the stagnation of productivity are risk factors. The gradual improvements in the growth of the region are explained by the unexpected progresses in the countries of the Eurozone, USA, China and Japan; by the rise in prices of raw materials that impacts on investment; as well as by a possible increase in global commercial exchanges; and by internal factors.
- Emerging markets will continue to be the **engine of global growth** and the technological factor will also be key to explaining how GDP will double and productivity will increase, while the labor market will face transformations. By 2050, the seven major emerging economies (China, India, Indonesia, Brazil, Russia, Mexico and Turkey) could increase their share of world GDP from 35 to 50%. China could be the world's largest economy, with 20% of world GDP; India would be ranked in second position and Indonesia in fourth position. Its importance for Latin America and the Caribbean lies in the greater number of products for production and consumption. For example, trade in goods between Latin America and the Caribbean and India increased from 2001 to 2016, reaching USD 30 billion. During that period, Indian imports increased by 22% annually, while exports increased by 16%.
- In the coming decades, the society and market in Latin America and the Caribbean **will change due to their exposure to three main forces**: the technological revolution, which will bring with it the entry of new disruptive technologies, which will essentially transform production, division of work, quality of life, governance and social relations; the demographic changes produced by rural displacements, changes in markets, in social strata, migration and greater service needs. Likewise, the region will be affected by climate change, due to the recurrence of extreme events that cause large economic losses. In this sense, the companies that are prepared for the foreseen changes will enjoy great opportunities for growth, and those that are not will probably tend to disappear or lose their presence.
- The **new technologies that have been emerging will be strengthened and will have an integral influence in all sectors of the economy**. As these technologies become more accessible and affordable, they will have a greater impact on growth, labor markets and income distribution. Those that would have more influence for the formulation of public policies and their implementation in Latin America and the Caribbean are *cloud computing*, which in Latin America and the Caribbean increased by 49%, although only 31% of companies are maturing or have managed to optimize its strategies to use it; big data, for which an income of USD 2.900 million was estimated in 2017 with a projection of USD 8.500 million in 2023 and a compound annual growth rate of 19.2%; the Internet of Things (IoT), to which 46% of the companies in Latin America and the Caribbean are familiar. However, only 10% have implemented a solution of this type. In contrast, 30% of companies in the USA and Europe already have this type of solution. The USA will make the largest investments in blockchain in the next 5 years, taking more than 40% of all related expense. Western Europe, China and Asia Pacific will be below that. This notwithstanding, the regions that will increase proportionally the most their *blockchain* spending will be Latin America and the Caribbean and Japan, with annualized rates of 152.5 and 127.3%. Although it is pertinent to mention that Latin America and the Caribbean start with a lower base.

- Big data provides the opportunity to find, extract, process, distribute and make profitable a great asset such as large volumes of **information** that allow for better knowledge, decision-making, customer segmentation, expansion of information sources, dynamizing by learning with new data and process automation. One out of every three business leaders does not trust its data, key to prediction and models; one third of business managers do not trust the information they use to make decisions. The poor quality of the data costs the US economy USD 3.1 trillion per year. For its part, the use of *blockchain* technology based on trust makes it possible to dispense with intermediaries in various activities, saving costs and giving fluidity to business relations between the parties.
- In this regard, it is worth emphasizing the KFW Digital Office, which allows identifying the most relevant technologies for the entity and promoting their application in different areas of its business; promoting "agile" methods within KfW and facilitating a change in KfW's culture. An example of the application of this technology is TruBudget ("Trusted Budget Expenditure"), a platform for follow-up and coordination of investments co-financed by donors, developed by KfW with the help of its "Digital Office" and co-financing from the German Government (BMZ), which is in the pilot phase in several countries. Cooperation with the Banco Nacional de Desenvolvimento Econômico e Social (BNDES), of Brazil, is in use for the "Fondo Amazônia" program in Brazil as a pilot project. The main advantages: Transparency for all stakeholders of the program progress (planning, implementation, financial flows, etc.); real-time information, complete traceability, etc.; and it facilitates co-financing by other institutions.
- Estimates made **in 10 developed countries indicate that Artificial Intelligence could double the GDP growth rate and increase work productivity** from 11 to 37% in developed countries. The regional gains due to the effects of Artificial Intelligence will be felt most strongly in China, which will receive a 26% increase in its GDP by 2030, followed by the United States (14.5%). Together, both countries will be almost 70%, or USD 10.7 billion of the global economic impact of Artificial Intelligence. Europe and the developed countries of Asia will also benefit significantly (from 9 to 12% of the GDP); meanwhile, the developing countries of Africa, Latin America and Asia will have modest gains (less than 6%).
- In the case of Latin America and the Caribbean, using the year 2035 as a comparison year, Artificial Intelligence has the **potential to add up to a percentage point to the** annual rates of economic growth in the region. Artificial Intelligence produces the greatest economic benefits in absolute terms for Brazil, culminating in additional USD 432 000 million in its gross value added (GVA) in 2035. This would imply a 0.9% boost for the growth of that year. Chile and Peru could increase their GVA by 1%.
- Artificial Intelligence, though it has made progress, still has **great limitations**. It can not explain why human beings have emotions, are creative, can tell right from wrong and show empathy. **It should not be seen as our economic salvation**; we must go step by step and look at the forces that restrict growth. In the case of weak productivity in Latin America and the Caribbean, what we must see is whether Artificial Intelligence can lead us to economic growth, which in practice it can do through three channels: 1) It can create a new virtual workforce called "intelligent automation"; 2) It can complement and improve the skills and capabilities of existing workforces and physical capital; and 3) Like other previous technologies, it can stimulate innovation in the economy beyond its direct performance. Over time, it will become a catalyst to achieve a broad structural transformation, since economies that use Artificial Intelligence not only do things differently, but they will do different things.
- The effects of Artificial Intelligence on productivity and growth seem to be clear, but not **on employment**. Despite the various studies, it is not defined how Artificial Intelligence and advanced automation will affect future employment opportunities in net terms. **Predictions as to what types of jobs will be replaced, and how quickly, will vary greatly.** Many significant innovations in the past have been associated with a transitional period of temporary loss, followed by recovery. The transformation of business and Artificial Intelligence will also follow that path. Artificial Intelligence will improve the productivity of many jobs, eliminating millions of medium and low level jobs, but creating millions of highly qualified personnel jobs. The answer will involve educating and re-training people in tasks where Artificial Intelligence tools do not stand out. This technology does not adapt well to works that involve creativity, planning and interdisciplinary thinking. However, the most

common is that these skills are required in well-paid jobs, and it would be difficult to retrain the workers displaced from these jobs.

- **Climate change also affects inequity, since the countries and populations** that are likely to be most affected are often the least responsible for causing it, and have limited capacity and resources to circumvent it. The World Bank states that, if measures to reduce vulnerability, provide access to basic services and generate resilience are not urgently adopted, by 2050 about 17 million people in Latin America and the Caribbean will be displaced due to climate reasons, adding to the millions that are already moving within their countries for economic, political or social reasons. **Until 2016, it was estimated that by 2030 natural disasters caused by climate change would generate losses of USD 314 000 million** a year in cities around the world, while 77 million people would live and work in poverty. However, the losses produced in the first months of 2017 by hurricanes in North America and the Caribbean, heavy rains and floods in South America —Peru, Ecuador and Argentina— and earthquakes in Mexico, already exceeded that amount of losses.
- **Greater urbanization should be an opportunity** to generate positive effects on the population, boosting economies and productivity. Latin American countries register relatively low levels of income, capital, work and productivity. Cities account for 54% of the world's population and three quarters of GDP. In Latin America and the Caribbean urbanization exceeds 82%, one or the highest in the world. One of the ways to take advantage of the ability of cities to improve the quality of life of their inhabitants is to encourage digitization, due to its significant impact on productivity and GDP growth. **For example, a 10% average increase in broadband penetration in the countries of** Latin America and the Caribbean **causes a 3.2% increase of GDP and 2.6% of productivity.** For this reason, it is important to think about the adoption of policies to take advantage of the new opportunities of the Fourth Industrial Revolution. The high rates of urbanization and urban density are comparative advantages that Latin American countries should explore.
- The time to **build resilience is now**. Urban resilience is the ability of individuals, communities, institutions, companies and systems to survive, adapt and grow, no **matter what type of chronic stress weakens the social fabric of a city permanently or cyclically**. Some examples of these tensions include high unemployment; inefficient public transport system; endemic violence; and chronic shortages of food and water; that is, sudden and acute events that threaten a city, including earthquakes, floods, outbreaks of diseases and terrorist attacks.
- **Building resilience in a city is not easy**: 1) Cities need to work in a new and integrating way among stakeholders and city agencies to understand the risks and challenges; 2) prioritize spending to address their most pressing resilience needs; 3) design projects that address multiple challenges through a special intervention; 4) track and measure the results of resilience. The challenges of urban resilience in Latin America and the Caribbean are limited capacity; governance; limited budget and capacity to access various sources of capital.
- *Development banks have the challenge* of 1) committing resources for project preparation and technical assistance to support the project design and include it in loan-taking; to serve as a catalyst for attracting investment and innovation from the private sector; 2) understanding the needs of cities and working with the national government to prioritize investments, build sub-sovereign capacity to independently access financing; 3) promoting technological and financial innovation in project design; 4) having as a mandate that resilience principles are included in the loan-granting practices.
- For the intervention in a post-crisis urban context, taking into account the previous conditions, more specific actions are recommended in urban areas under two approaches. One is the multi-stakeholder approach, which means making the inhabitant not only a simple beneficiary but also a leading stakeholder in the project, that allows accompanying the resilience; creating alliances respecting the legitimacy, competences and capacities of each stakeholder: the challenge of recognizing the complementarities of each one; taking into account the economic dimension of the city and the importance of the role of the private sector in the city; and strengthening the governance mechanisms, especially the dialogue between populations and institutions. The second approach is the temporal space and assumes accepting differences of temporality: urgency/physical reconstruction/institutional reconstruction; the need to reinject urban expertise (urban planners, territorial organizers, property lawyers) from the emergency phase; and work with an integrated

vision. For example, one cannot work on housing without working on the networks and on the properties, which implies multiple stakeholders.

- Institutional experiences of preventive or post-crisis intervention were presented by three development banks. The Financiera del Desarrollo (Findeter) of Colombia, which showed the comparative results between a city with sustainable planned development versus another that had not implemented plans of this nature. In terms of human lives, people affected and houses destroyed, the balance was more negative in the city that lacked good planning and implementation of sustainability plans. In Colombia, it has been estimated that it is seven times more expensive to respond to emergencies arising from natural disasters than to invest in works to mitigate risks. For its part, Nacional Financiera (Nafin) of Mexico has the Emerging Program for Economic Reactivation, supporting with credit guarantees of the private financial intermediaries of the affected companies. The program acts in the face of natural disasters or relevant events (health contingencies, strikes or protests). It is activated once a declaration of emergency is issued by a federal authority, and it has counter-guarantee contributions from the federal and state governments. Nafin guarantees up to 100% of the credit granted and public resources are enhanced up to seven times. In turn, Banco del Ahorro Nacional y Servicios Financieros (Bansefi), also of Mexico, acts in the post-crisis period from the perspective of supporting people with financial services. The program allowed a delivery of supports with maximum safety, efficacy and efficiency; providing service directly in the homes of those affected, with instruments to promote savings; financial inclusion with freedom to determine the use of resources, against the traditional response that the Government rebuilds directly; in addition to transparency in the delivery of resources; financial education for the use of cards for ATM withdrawals. 95.8% of beneficiaries were served and USD 393 million were distributed.
- The Development Banking (DB) has the great opportunity to be **one of the leading stakeholders in the process of changing the traditional model of direct financing of public projects** towards a new paradigm based on the mobilization of resources and the optimization of the use of capital, in a context of reduced availability of external capital and fiscal restraint in the countries of Latin America and the Caribbean. For this purpose, it is necessary for the Development Banking to build the capacities that allow it to go from being a traditional credit banking to a modern financial engineering banking; a bank that uses advanced instruments to mobilize private resources, which seeks innovative sources of financing to optimize the use of its capital. Also, using risk sharing mechanisms: syndicated loans for project financing, strengthening of credit and guarantees, products of export credit agencies (ECAs), co-investment in venture capital and private equity funds, etc.; promoting competition by supporting non-banking financial institutions to focus on specific segments; improving coordination and solving other problems and taking direct risk only when there is no market.
- When the market conditions and the regulatory framework are insufficient, the Development Banking can play a catalytic role in the financing of infrastructures, purely financial interventions to resolve market failures (lack of capacities, poor market development, asymmetric information, etc.) or interventions to support those responsible for public-private partnerships (PPPs) to improve the quality of project preparation. The development bank should complement when there are no markets, but as conditions improve, it should be prepared to take a step back.
- In the future, **the** Development Banking **must focus its interventions on the financial intermediation of risks that facilitate investments in projects of a collective nature** (public-private), with long periods of maturation and uncertain returns (typical of the innovation process). In these particular cases, the intervention of the Development Banking has the potential to accelerate these processes through development, at pilot scale, of projects that promote greater competition in the market. This challenge will require consolidating a corporate vision for the same Development Banking, developing its strategic planning to consolidate in the State long-term institutions capable of assuming an entrepreneurial role in the economy.
- **Assembling with other stakeholders, from the Government and the market, the design of their intervention.** The sectoral specialization of certain market stakeholders or public agencies is crucial for a correct understanding of the risks associated with investment. Strategic alliances to jointly face the study and implementation of new financial instruments enable, to a large extent, to avoid the oversizing of the intervention and other typical “Government failures”.

- The Development Banking can play a crucial role in the development of countries. Its contribution to access to financial services, to the promotion of entrepreneurship and innovation and to the leverage of greater resources for infrastructure, can be a relevant factor to boost economic growth. **However, the creation of this type of institution, by itself, is not a guarantee of effectiveness. Three additional elements could ensure the conditions for success:** 1) The clarity of the strategic objective and focus on the mandate for which it was created; 2) A good corporate governance that includes transparency of information, independence of the board of directors and accountability mechanisms, is essential for these institutions to find a balance between, on one hand, assuming greater risk in the fulfillment of their mission and, on the other hand, maintaining a solid management of their assets and financial viability; 3) The quality of the country-specific regulations that affect these institutions. These must ensure that the role of the State as owner and regulator is not mixed, thus avoiding conflicts of interest. Regulation should make it easier for successful innovations driven by public institutions to be adopted by private financial stakeholders.

- Alliance with stakeholders from the private sector to promote access to financing with market stakeholders specialized in covering specific risks. Likewise, the specialization of the Development Banking in the management of risks to structure monitoring mechanisms and make them effective will be vital to improve the situation of small producers and cooperatives, often captured by unfavorable financing schemes. High uncertainty and information problems are also particularly important in rural areas.

- Need for **political audacity to implement successful experiments**. We face a particular challenge in our region, product of our own history, which is the political aversion to this type of measures to promote competition. Even the drive for minimal interventions will require great political audacity in order to develop this type of experiments from Development Banking. However, the successful demonstration effect generates confidence in the role of our institutions, laying the foundations for the change of political conception towards the future.

- Some more immediate specific actions that the Development Banking can take in the new paradigm of public financing: a) **Accompanying the Government and the corresponding public-private partnerships (PPPs) agencies** on the innovation path, regarding the adoption of financial engineering techniques for the mobilization of resources in favor of their country; supporting subnational and national governments in everything related to the financial structuring of PPPs; acting as **Government adviser in everything related to the design and implementation of the credit enhancer facility or risk reduction**. In order to attract international investment, mainly institutional investment, it is important to have suitable investment vehicles and support the **creation of negotiable instruments derived from the financing of *project finance***; as well as **a set of negotiable instruments at the regional or subregional level**.

- **Building based on a learning process of experimental innovation, to face "in the laboratory" interventions capable of replicating on a larger scale in the market.** Under this scheme, the Development Banking may provide long-term capital to retain critical technical risks of the project and thus attract more private funding to support the repayment of financing. In exchange for this contribution, banks would charge a risk premium in order to achieve the minimum profitability that ensures their financial sustainability. In the event of success, the commercial scaling would be driven by private capital investments, in which Development Banking may preserve its participation in order to recoup its initial investment and, if possible, generate surpluses.

- Maintaining the international foray to advance in positioning strategies as Development Banking; exploring different alternatives of adequate and timely funding to leverage growth and its potential diversification, with new products according to the needs of companies and people; deepening its relationship with local or subnational governments for investment in urban development projects that improve the quality of life of the population, which, as envisaged, is increasingly concentrated in cities; acting in an integrated manner in an organic set of measures and actions together with the private sector to ensure the sustainability of financing and investment flows and stimulate mutual learning about development ideas and practices that involve the mobilization of cross-border funds to economic zones and industrial parks; and the anticipated development of solutions for possible problems in accordance with global trends.

- For Development Banking, financial inclusion is very important because it entails welfare gains. Access to savings and credit mechanisms can release the efficient allocation of resources by preventing the implementation of socially profitable investment projects. Likewise, it can reduce transaction costs in the economy, by encouraging a more extensive use of payment systems and increasing the possibilities of economic agents to obtain adequate risk coverage. To this end, the development banks in the region have innovated in a variety of instruments, programs and initiatives to facilitate financial inclusion in different segments of society, both in the rural and urban sectors.

- The innovation in new communication and information technologies has constituted an important support for the development of products that, operated through web platforms, allow the massification of credits, better allocation of support, provision of low-cost service, provision of fast real-time service, provision of a set of services (training, information, credit, technical assistance and guarantees), timely and independent consideration of distance, linking and realization of business among customers. That is, it is linked to customers not only with the bank but also with each other.
- As a way to reach the sectors that demand credits in small amounts or are further away geographically, and to reduce the risks, development banks have agreed to establish alliances with non-banking financial intermediaries. To do this, in addition to promoting their formation and development by facilitating funding and assuming some operating costs, they provide training to the personnel of said financial institutions or provide guarantees, through the creation of national guarantee funds administered on behalf of development banks, created by themselves or promoting their creation with a share in the capital.