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Time to get serious at the IDB

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The Inter-American Development Bank is the oldest regional development institution, established in Washington DC in 1959 to help address the economic and social needs of Latin America and the Caribbean. However, the bank has not always made decisions that are in the best interests of its shareholders – or of the people in the region. The time has come for the Latin American and Caribbean shareholders of the IDB to join the ongoing effort to strengthen and professionalise the bank, especially by raising its lending standards.

The root of the problem is that the balance of decision-making authority at the IDB favours the 26 shareholding countries that borrow from the bank, ranging from Argentina to Venezuela, rather than the countries which are also stockholders but do not borrow from the IDB – the US, Japan, Canada and others mostly from Europe. When the executive directors from Latin America and the Caribbean vote as a bloc, which they almost always do, they muster the more than 50 per cent board majority needed to approve the loans that their governments have requested from the bank's staff. This unusual ownership structure, which puts Latin American governments in the IDB's driver's seat, invites conflicts of interest, collusion and self-dealing.

Therefore, even though the US is by far the IDB's principal stockholder, and its 30 per cent capital contribution is the highest such US stake in any multilateral bank, its clout is relatively limited. It is only when the IDB needs to raise more capital from its non-regional shareholders – the ones with deep pockets – that the borrowing countries court the US and the other stakeholders with promises to take steps to depoliticise and improve the institution.

For example, in 2010, as part of the process to secure approval for the IDB's ninth general capital increase, its board of governors passed a series of reforms intended to strengthen the bank's strategic focus, development effectiveness and efficiency. One of the measures mandated the preparation of a yearly, confidential "macroeconomic sustainability assessment" for each borrowing country, with a favourable judgement becoming one of the prerequisites for the maintenance of countries' access to IDB loans – to avoid throwing good money after bad.

It was agreed that unsustainable macroeconomic conditions would be understood to exist in a country when, whatever their cause, there was a strong likelihood that within the next two years it would experience an inability to fulfil public debt obligations; a shortage of foreign exchange for the normal functioning of the economy; the need to rescue financial institutions; or a prolonged and destabilising inflationary process.

Argentina and Venezuela are two countries that have been experiencing deepening economic problems during recent years. Economic policies in both have featured populist fiscal, monetary, income-redistributing, and other investment-unfriendly measures which have degraded their creditworthiness, led to the rationing of dollars via stringent capital controls, and generated sustained, double-digit inflation – recently, around 25 and 55 per cent, respectively. One would expect, therefore, that the IDB would have scaled back lending to both these countries, because they are paragons of macroeconomic unsustainability.

According to the IDB's strategy document drafted three years ago, Venezuela had the green light to receive approvals for $900m in loans per annum during 2011-14. In the past three years, however, the IDB has granted loans to Venezuela for a mere $520m in total – one-fifth of the amount originally on offer. This is consistent with the country failing to get a passing grade.

In the case of Argentina, in contrast, the IDB's staff and board of executive directors have kept approving loans despite opposition from donor countries, led by the US. During 2011-13, loan authorizations for Argentina averaged $1.3bn per annum, the same pace as during 2008-10. Despite deteriorated economic fundamentals, the IDB's strategy document on Argentina dated November 2012 actually envisioned annual approvals as high as $1.5bn through 2015. It is no wonder that a report by the IDB's independent Office of Evaluation and Oversight recently concluded that the staff's macroeconomic sustainability assessments "have suffered from confused objectives and a non-transparent process, in addition to inherent problems of methodology."

The time has come for the management and the borrowing countries at the IDB to get serious about their commitment to strengthen the bank's lending standards, including by cutting back sharply on new credit to risky member-clients like Argentina.

As it is, Standard & Poor's has recently penalized the IDB for its excessively large exposure to just five nations which account for about 70 per cent of its loan and guarantee book – among them to Argentina, which S&P rates as CCC+ because it is teetering on the edge of renewed default. Under a conservative credit policy, every dollar that is not lent to Argentina would free up several dollars that the IDB could lend to needy but responsible countries elsewhere in the region. The IDB's stand-alone credit rating is a notch below AAA, according to S&P, so the bank's reputation and ultra-low-cost funding are also at stake every time the bank throws good money after bad.

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http://blogs.ft.com/beyond-brics/2014/01/13/guest-post-time-to-get-serious-at-the-idb/#axzz2qIXBffrR