Office of Evaluation and Oversight

Mid-term Evaluation of
IDB-9 Commitments

Competitive Regional and Global International Integration

Background Paper

Inter-American Development Bank
March 2013

Classification: Public Document
Original Version: English

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ABSTRACT

Trade and regional integration in Latin America and the Caribbean (LAC) have been constant goals of the Inter-American Development Bank (IDB, or Bank) since its inception. While the Bank has historically had a very active role in policy discussions with and technical assistance to countries on these issues, it has not had a substantial regional lending program in this area. Indeed, the trade and integration portfolio is divided between the nonlending part, mostly led by the Trade and Integration Sector, and the infrastructure integration part (where the bulk of the lending is concentrated), led by the infrastructure sector. However, this lending portfolio is composed almost exclusively of national projects with typically no proven regional benefits beyond the purely national ones. The main reason for the paucity of projects with regional benefits is that working regionally is associated with higher transaction costs for both the Bank and the countries, and the Bank still lacks a concessional lending instrument.

Under the IDB-9 Agreement, the Bank reiterated regional integration as one of the priorities, attaching a specific lending target to it. Management was required to produce a new regional integration strategy and an action plan to guide the actions of the Bank. The new Integration Strategy has a thorough understanding of the nature of the challenges to regional integration and contains a complete and sound diagnosis of trade issues in LAC. Although the diagnosis of infrastructure integration and regional public goods is weaker, the Strategy remains relevant to identify the main challenges and the recent evolution of trade and integration in LAC.

The Strategy and Action Plan provide little guidance, however, beyond outlining the main ideas. Although a first draft identified the need for concessional instruments, the final version proposed only a “smart mix” of existing instruments. The Strategy does not clearly define and build on the Bank’s comparative advantage or record of past experience. The definition and classification of “regional integration projects” are confused; depending on the source chosen, regional integration projects represent between 0.6% and 25% of Bank lending in 2011. The baseline for lending in the IDB-9 Agreement (10%) is unrealistic given the Bank’s historic performance, and projects without any connection with either regional integration or the Integration Strategy are being labeled as regional. The Strategy and the Action Plan mostly describe what the Bank currently does rather than provide strategic leadership or direction.

The Bank is now at a crossroads. Different options are available depending on the risk appetite of Governors and the willingness of the LAC Region to advance toward regional integration. Instead of pursuing the current low-risk and low-payoff strategy, Governors may wish to tackle the problems that have precluded lending for regional integration, including providing preferential access to resources for regional integration projects with clear eligibility guidelines. In any case Management should revisit its classification system for regional lending and provide a more transparent and more accurate picture of actual Bank work in this area.

PREFACE

The Inter-American Development Bank (IDB) is in a period of rapid change, responding to both the economic dynamism of the Region it serves and the increasing competition in the international financial marketplace. Over the past decade, countries in Latin America and the Caribbean have gained greater access to alternative sources of finance and an increasingly ability to generate and share knowledge among themselves. Like other multilateral development banks, IDB is seeking to adapt to this changing international landscape by ensuring that it is responsive to borrowing countries' needs and putting strong emphasis on effectiveness in its use of scarce resources.

In 2010 the IDB's Board of Governors approved the 9th General Capital Increase of the IDB (IDB-9). The IDB-9 Agreement laid out a series of reforms intended to strengthen the strategic focus, development effectiveness, and efficiency of the IDB to help it remain competitive and relevant in the years ahead. As part of that Report, IDB's Office of Evaluation and Oversight (OVE) was charged with conducting a midterm evaluation—to be presented to the Board of Governors in March 2013—to assess IDB's progress in implementing those reforms. The full evaluation is available at www.iadb.org\evaluation.

This paper is one of 22 background papers prepared by OVE as input to the IDB-9 evaluation. It seeks to determine whether one portion of the IDB-9 requirements has been implemented fully and effectively and to offer suggestions to strengthen implementation going forward. The overarching goal of this paper and the entire evaluation is to provide insights to the Governors, the Board, and IDB Management to help make IDB as strong and effective as possible in promoting economic growth and poverty reduction in Latin America and the Caribbean.

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This background paper is dedicated to the memory of Felipe Herrera, first President of the Inter-American Development Bank and indefatigable champion of regional integration in Latin America and the Caribbean. The paper was prepared by Juan Manuel Puerta with the support of Laura Atuesta. The recent evaluation of Transnational Projects (RE-415, link) is an important input to this paper, and we would like to acknowledge the contribution of the team that worked on that evaluation. We have also benefited from discussions with the Integration division, particularly Paolo Giordano and Joaquim Tres. All background papers were thoroughly reviewed and discussed within OVE and shared with IDB management for comments. The other background papers and full IDB-9 evaluation can be found at www.iadb.org/evaluation.

ABBREVIATIONS AND ACRONYMS

ALBA	Bolivarian Alliance for the Americas
ALADI	Latin American Association of Integration
CABEI	Central American Bank for Economic Integration
CACM	Central America Common Market
CAF	Andean Development Corporation
CAFTA-DR	Dominican Republic- Central America Free Trade Agreement
CAN	Comunidad Andina de Naciones
CARICOM	Caribbean Community
CARIFORUM-EU	Caribbean Forum- European Union Economic Partnership Agreement
CARIFTA	Caribbean Free Trade Association
CELAC	Community of Latin American and Caribbean States
DEM	Development Effectiveness Matrix
DEO	Development Effectiveness Overview
EU	European Union
FDI	Foreign direct investment
FIRII	Fund for the Financing of Technical Cooperation for Initiatives for Regional Infrastructure Integration
FIRII+/RIIF	Regional Infrastructure Integration Fund
FONPLATA	Fund of Plata Basin
FSO	Fund for Special Operations
FTA	Free trade agreement
FTAA	Free Trade Area of the Americas
GCI-9	Ninth General Capital Increase
GDP	Gross domestic product
IDB	Inter-American Development Bank
IDB-9	Ninth General Capital Increase for the IDB
IIRSA	Initiative for South American Regional Infrastructure Integration
INE	Infrastructure and Environment Sector
INT	Integration and Trade Sector
INTAL	Institute for the Integration of Latin America and the Caribbean
LAC	Latin America and the Caribbean
LAFTA	Latin American Free Trade Association
MDB	Multilateral development bank
NSG	Non-sovereign guarantee
OVE	Office of Evaluation and Oversight
PFLAI	Preinvestment Fund for Latin American Integration
PPP-PM	*Plan Puebla Panamá-Proyecto Mesoamérica*
RTC	Regional Technical Cooperation
RPG	Regional Public Goods
SCF	Structured and Corporate Finance Department
SICA	Central America Integration System
SIEPAC	Central American Electrical Interconnection System
SPD	Office of Strategic Planning and Development Effectiveness
VPC	Office of the Vice President for Countries
VPS	Office of the Vice President for Sectors

EXECUTIVE SUMMARY

Regional integration and cooperation has been a constant goal of the Inter-American Development Bank (IDB, or Bank) since its inception. Historically, the Bank has been inextricably intertwined with the integration process in Latin America and the Caribbean (LAC), to which it owes its creation and to which it has significantly contributed, particularly early in its history. After a period of lethargy in the 1980s, the Region found a new integration paradigm in the 1990s under the “new regionalism.” The Bank swiftly responded with the creation of the Integration and Trade Sector (INT) and the approval of an Integration Strategy. Turning this integrationist spirit into a lending program has proved to be a persistent challenge for the institution: historically, no more than 5% of the Bank’s loans have been devoted to regional integration and cooperation.

IDB—like other development institutions (for example, the World Bank and the African and Asian Development Banks)—has long been aware of the challenges related to funding regional integration projects. Even when loans are executed at national level, effectively designing and coordinating ambitious regional integration projects entails higher costs, longer preparation and execution times, and higher vulnerability to political shocks—all strong disincentives for both the Bank and the countries. The Office of Evaluation and Oversight (OVE) has repeatedly maintained that the lack of adequate instruments to deal with these projects is a major constraint to the relevance of the Bank’s regional integration program (RE-338, RE-350, RE-415). Management has also long noted the built-in challenges of regional integration projects: for instance, on justifying the use of resources from the Fund for Special Operations (FSO) to finance a program with the Central American Bank for Economic Integration, Management stated that “integration projects require a special incentive, since the countries tend to assign higher priority to the use of their resources for projects of interest and benefit on the national level” (PR-452, 1970). More recently, both the former integration strategy (GN-2245-1) and the first background paper for the new Strategy (GN-2565) have insisted on the need for a financial instrument to overcome the disincentives countries face. Similarly, the Board of Governors acknowledged that projects with cross-border externalities were “special operations” and granted eligibility for FSO resources (AB-303-3, May 1972). This mandate—although difficult to implement as FSO resources dwindled—is still technically valid.

The Bank has tried to address the issue of lack of incentives for regional integration projects, with limited results. With declining FSO resources to subsidize lending and technical assistance for regional integration projects, the Bank has resorted to different instruments to tackle the issue: it created a sector facility for transnational projects in 2003 (GN-2085-10) and twice established small preinvestment windows for regional infrastructure projects. All these windows faced limited demand because they were not financially attractive for borrowers. For example, the Fund for the Financing of Technical Cooperation for Initiatives for Regional infrastructure Integration (FIRII) was initially conceived as a contingent recovery facility; when demand failed to materialize, it was converted to a nonreimbursable window. More recently, the Bank also created some sector and thematic trust funds (Aid for Trade, FIRII+) to support technical assistance. Despite these new funds, the resources available for regional cooperation have dwindled,

not least because the Governors' mandate to transfer the FSO-financed Regional Technical Cooperation program to ordinary capital has not yet been carried out.

As a consequence, the Bank lending program for trade and integration has been de facto (75%) lending for infrastructure projects that are designed and executed as national infrastructure projects. While national projects—if designed and coordinated within a transnational framework—may display regional benefits, the Bank still has no effective mechanism to evaluate the regional contribution of projects. As OVE has noted, the Bank's infrastructure integration projects are designed and executed exactly like national infrastructure projects (RE-338, RE-350). Aside from infrastructure integration, only a very small part (about 5%) of the Bank's lending deals with national trade and integration projects (e.g., border crossings) that contribute to regional integration. Without any preferential treatment to compensate for the higher transaction costs of regional integration projects, the Bank has had only two projects with significant cross-border externalities since 2000. These projects materialized when the Bank managed to secure ad hoc concessional resources from bilateral donors (Spain, Norway, and Germany).

As part of the IDB-9 Agreement, Management was requested to produce a strategy for regional integration to "define the main priorities…and offer guidance to staff on the design and implementation of programs and projects." The Strategy was submitted in a timely manner, with all the supporting annexes and evidence, and a few months afterwards an Action Plan was approved. The Strategy benefited from a thorough diagnostic and valuable background papers on the challenges to regional integration—particularly focusing on international trade. Thus OVE finds that the requirement for a Regional Integration Strategy is fully implemented. However, effective implementation requires that the Strategy show the capacity to guide the Bank's future behavior.

The new Integration Strategy (GN-2564-4) identifies operational challenges related to working at a regional level: the high costs for countries, particularly regarding coordination; the asymmetries in the distribution of costs and benefits; and the limited incentives for Bank staff to engage in what are generally nonlending operations. OVE agrees with this diagnostic, as it has noted in many recent evaluations (RE-338, RE-350, RE-415). OVE also agrees with Management's initial drive to develop "new instruments" (i.e., improving the economic conditions) for regional integration. Although the Board of Governors initially expressed support for the "development of specific instruments for regional projects and programs," in the discussions at the Board of Executive Directors, several chairs noted that a new instrument "would not be needed for most integration projects." As a consequence, the final version of the Integration Strategy misses the opportunity to address the crucial issue of lack of preferential treatment for regional integration operations. Instead, it proposes a "smart mix" of existing financial and nonfinancial instruments (e.g., policy research, capacity building, programming, and financial instruments).

Although a good tool to understand the available instruments, the "smart mix" as described in the Strategy falls short of providing any strategic guidance as to how these "instruments" will be applied and exactly how they will generate the demand for regional integration operations that has been historically so elusive. Given these challenges, the

Strategy could have benefited from explicit stocktaking of the Bank's previous strategic approach, namely the "toolkit of financial and non-financial instruments" (GN-2245-1). In particular, it would be useful to have an explicit comparison of both approaches, indicating the similarities and differences.

The document provides limited guidance on the organizational aspects of regional work at the IDB—how the Strategy will be articulated across the Bank, and what role INT will have in ensuring the achievement of the goals, when it leads the strategic discussions but the Infrastructure and Environment Sector (INE) leads the lending activities. Although Management has expressed the view that coordination has improved between INE and INT, the effect of adding a "regional integration" perspective into infrastructure integration projects has yet to be seen. Finally, it is difficult to say whether the goals of the Strategy are adequate, as there is no indication of whether they are in line with the available means. In particular, the Strategy fails to quantify the size of the interventions and to discuss alternative partnerships and resource mobilization, which are crucial in the context of the dwindling resources available for regional technical cooperation. The quality of the indicators identified in the Strategy—inherited from the IDB-9 report—is poor, and the identification of risks is largely ineffective. It is for all these reasons that OVE finds that despite the important efforts of Management, the Strategy and the Action Plan provide very limited guidance for action, and, therefore, are partially ineffective.

In addition, there seems to be generalized confusion and lack of transparency regarding the definition and classification of regional projects. The definition proposed by the strategy is too broad and operationally unpractical. The guidelines developed by the Office of Strategic Planning and Development Effectiveness (SPD) resulted in a direct mapping of projects from specific sectors and subsectors or specific strategic initiatives into regional integration projects. In practice, this approach has not excluded any Bank project from being regional, and it pre-identified about one-third of the subsectors as being likely to contribute to regional integration. While a sector-specific criterion may be not so distortive in software projects (trade portfolio), it is largely inadequate for the infrastructure integration projects that constitute the bulk of the portfolio covered by the Strategy. The inaccuracy of the present methodology is illustrated by the fact that if the SPD guidelines for classifying regional projects were applied retroactively, they would indicate that between 20% and 40% percent of Bank lending was regional in 2006-2009—that is, the 2015 target (15%) would already have been easily achieved at the baseline. OVE also found that the calculation of the baseline proposed in the IDB-9 Report (10%) is particularly affected by the timing of two large infrastructure operations in Argentina and does not reflect the Bank's historical engagement in regional integration (less than 5%).

Moreover, OVE found serious difficulties with the application of the rules for classifying projects that contribute to the regional integration lending target.

- There are pervasive inconsistencies between the classification of regional projects as presented by the different Bank reports and databases—for example, Development Effectiveness Matrix (DEM), Development Effectiveness Overview (DEO), and OPUS). And these differences are

significant; for instance, according to OPUS, regional integration projects were about 0.6% of Bank lending in 2011; the DEO classifies 12% of that year's lending as regional; and if all the projects with a DEM that indicates alignment with "regional integration" are summed, about US$2.5 billion (roughly 25%) of Bank overall lending in 2011 would be regional. Furthermore, using the OPUS database it is impossible to recreate the baseline of the IDB-9 Agreement (10% for 2006-2009).

- Even documents that have been produced almost simultaneously have very different implications in terms of regional integration lending.

- Projects that are very similar in nature (e.g., phases of conditional credit line) receive different treatment regarding their regional integration contribution.

- Finally, projects that bear no discernible connection with the Governors' mandate for regional integration (e.g., citizen security, fiscal consolidation policy-based loans) have been identified as contributing to regional integration.

In view of all these challenges, OVE is concerned with the potential misrepresentation of the Bank's regional integration work. Not only there is a reputational risk for the IDB but, more importantly, by exaggerating its contribution to regional integration, the Bank misses the opportunity to address the real challenges that have hindered the effectiveness of its regional integration program.

It is precisely with the recent capital increase—and its renewed commitment to regional integration—that decisions about the future strategy should be taken. In this context, OVE's first suggestion—directed to Governors—focuses on the different alternatives for this new strategic positioning, providing a choice between continuity and change. The second suggestion—directed to Management—focuses on the classification of regional projects. Unfortunately, the concerns of some Directors regarding "creative accounting" to meet the lending target were justified.[1] In that sense, OVE calls on Management to provide a clear, transparent, and candid assessment regarding the projects that are counted toward the regional integration target.

Suggestion 1: Define the new strategic approach to regional integration based on risk appetite. At this crossroads, the Governors of the Bank have an opportunity to redefine the role they envision for the institution in terms of regional integration and cooperation. Two options emerge. One—the one proposed by the integration strategy—does not require any major change and proposes a sort of enhanced continuity, where an effort is made to coordinate existing financial and nonfinancial instruments under a "smart mix" of instruments. Without more details, it is not very clear how the present Strategy will succeed where the previous one failed. Also, without specific economic incentives to countries, it is unlikely that a greater demand for regional integration

[1] See PEA/11/4.

projects would emerge (particularly, those that Governors stressed in Table III-2 of the GCI-9 document), and the demand for trade projects is quite limited. In consequence, the resulting equilibrium is likely to be similar to the one we now have: most of the lending would be devoted to infrastructure integration projects with no proved (and unlikely) regional contribution. A minimum share of the loans would go to national trade sector loans (customs, export promotion). This approach seems to be very conservative and entails very low risk. In particular, it does not require an increase in resources or granting any preferential treatment for regional integration projects. It should be noted that the payoff in terms of its contribution to regional integration is also very low.

A second approach is to tackle the real problem that has been precluding the development of lending for regional integration—not only in the IDB but also in other multilateral development banks (MDBs). This is the lack of preferential conditions to support projects that effectively contribute to regional integration, such as national projects effectively coordinated in a transnational framework, or multicountry projects. If this option is pursued, Governors would have to make the necessary resource allocations, including increasing the attractiveness of regional integration projects through more concessionality, more technical cooperation, and possibly an earmarked envelope from ordinary capital. Once the resources are secured, the Bank would need to develop a clear and transparent methodology to distinguish which projects—in the light of their contribution to regional integration—are likely to need preferential treatment and which would not. Transparency and clarity are essential preconditions, as once the preferential window is open, perverse incentives to disguise nonregional projects as regional projects may arise. Also, Management's incentives to engage in regional integration projects would have to be reconsidered. As for the likely outcome, all the MDBs that have created a regional lending program have faced important operational challenges, including higher costs and risks. However, the development impact is potentially high.

OVE finds that both options are reasonable, and they map the set of possible risks and payoffs. The right choice essentially depends on the risk appetite of Governors and the willingness to boost the Bank's role in regional integration and cooperation.

Suggestion 2: Improve Measurement of Projects contributing to the Lending Target. Irrespective of the strategic path the Bank decides to follow, in the future it will be essential to have an accurate measurement of the Bank's contribution to regional projects. The Bank's contribution to regional integration is not increased if projects get relabeled. In that regard, in the future, Management should submit a practical and actionable definition of regional integration projects to the Board of Executive Directors, including (i) precise guidelines on how they intend to apply it to the Bank's future lending, and (ii) a tentative classification of the pipeline for 2013-2014 using the proposed definition. It would be then up to the Board of Executive Directors to decide whether the Governors' intent as set forth in Cancun is fully captured by the proposed definition. Once the definition is agreed on, it should be (i) applied on a project-by-project basis (i.e., no automatic categories); (ii) briefly justified in the project document; (iii) fully linked to (and consistent with) the Bank's databases (particularly OPUS and DEM); and (iv) accessible through the Internet, where progress toward the lending

target—including the projects that are contributing to it—could be tracked by the Board of Executive Directors, Management, and other stakeholders in the Region.

It is likely that once an earnest assessment of the Bank's regional integration portfolio is made, the Bank's alleged contribution will be significantly reduced. If that were the case, it might be necessary for Governors to rethink the appropriateness of the objectives and the lending target in view of the available instruments, the resources the Bank is willing to commit to regional integration, and the political will of the Region to move forward with this priority.

I. INTRODUCTION

Latin America is not a collection of nations; it is a great nation shattered."
Felipe Herrera, 1962[2]

A. Background and IDB-9 requirements

1.1 Regional integration and cooperation has been a constant goal of the Inter-American Development Bank (IDB, or Bank). The Bank's origins are inextricably intertwined with the integration process of the countries of Latin America and the Caribbean (LAC)—a process from which it originated and which it has always supported. In its first two decades, the Bank promoted research in trade and integration, provided funding for intraregional trade in capital goods, and promoted some investments in transnational programs. After a period of lethargy in the 1980s, the Bank adopted a market-based approach in response to the "new regionalism." In the 2000s, the increasing interregional dependence among countries increased the Bank's opportunity to focus on functional cooperation and coordination for the provision of regional public goods. Throughout the Bank's history, most of its support has been provided in the form of technical cooperation and policy advice; lending for regional integration has always been a challenge.

1.2 The Bank has recently renewed its focus on regional and global integration. All but one of the Bank's capital increases—including the Ninth Capital Increase (IDB-9)—restated the commitment to regional integration (see Annex A). In March 2010, the Cancún declaration highlighted the need to set "clear, written institutional and sector priorities with notional lending targets, particularly for supporting the poorest populations and the poorest countries, regional integration, and climate change investments."[3] Later in 2010, the IDB-9 Report further elaborated the need to focus on regional integration as one of four sector priorities.[4] In that report, the Governors reiterated the commitment to integration by noting that the Region has experienced a wave of regional trade agreements

[2] The full citation in Spanish: "No es entidad ficticia la nación latinoamericana. Subyacente en la raíz de nuestros estados modernos, persiste como fuerza vital y realidad profunda. Sobre su secular material indígena, diversas sus formas y maneras, pero similar en su esencia, lleva el sello de tres siglos de dominación ibera. Experiencia, instituciones, cultura e influencia afines la formaron desde México hasta el Estrecho de Magallanes. Así, unitaria en espíritu y en su fuerza, se levantó para su independencia. Si América Latina quiere recobrar el tiempo perdido para no quedar definitivamente rezagada en la Historia, ha de acelerar el ritmo de su integración económica, y para ello hacer frente a la necesidad de su integración política. Muchas condiciones y circunstancias de su realidad histórica, geográfica y humana favorecen uno y otro intento. A ella como unidad, le toca recobrar el impulso de un proceso de desarrollo económico frustrado, más que iniciar uno nuevo, América Latina no es un conjunto de naciones: es una gran nación deshecha." The full reference comes from a speech of Felipe Herrera in Bahia, Brazil, on August 6, 1962, and was obtained from Herrera, Felipe, "La Tarea Inconclusa: America Latina Integrada," *Revista de Estudios Internacionales*, Universidad de Chile.

[3] AB-2728, Cancún Declaration, para. 4. a.

[4] The sector priorities are social policy for equity and productivity; infrastructure for competitiveness and social welfare; institutions for growth and social welfare; and competitive regional and global international integration.

following the unilateral commercial liberalization of the early 1990s, and, to take full advantage of this process, "investments in areas such as the administration and harmonization of rules of origin, customs procedures, sanitary and technical standards, and upgrading trade-related institutions are needed."[5]

1.3 In addition, the IDB-9 Report requested Management to submit to the Board, before the first quarter of 2011, a regional integration strategy.[6] The report elaborates on the objective of developing sector strategies: to "define the main priorities" and to "offer guidance to staff on the design and implementation of programs and projects."[7] On March 22, 2011—one week before the deadline—the Board discussed and approved the *Strategy to Support Competitive Global and Regional Integration in the LAC Region* (GN-2565-4) (Integration Strategy) proposed by the Bank's Integration and Trade Sector (INT) to replace the previous integration strategy (GN-2245-1) discussed in 2003. On February 2012, INT submitted an Action Plan to map "the road to 2015 by defining actions and resources to pursue the objectives defined in the Strategy, assigning responsibility, and defining timeframes."[8]

B. Methodology

1.4 Both the IDB-9 Report (AB-2764) and the Cancún Declaration (AB-2728) require the Office of Evaluation and Oversight (OVE) to evaluate the "full and effective" implementation of the reforms. This background paper addresses the reforms related to the regional and global integration sector priority. It assesses the progress of implementation of the Strategy to support competitive global and regional integration (GN-2565-4) and, more broadly, considers the Strategy's adequacy to achieve the organizational objectives, including the specific sector lending target mandated by the Governors. The evaluation draws on approximately 300 interviews with Bank staff and managers, clients, comparator institutions, and regional international organizations (see List of Interviews). This was complemented by a desk review of projects, and the findings from recent evaluations, particularly OVE's evaluation of the IDB's transnational programs (RE-415) and its background papers. In particular, the evaluation complements and extends the analysis carried out in RE-415 by (i) focusing on the whole trade and integration portfolio, and (ii) paying special attention to the Strategy and the Action Plan. In doing so, this evaluation also addresses Management's comments to OVE (RE-415-1, par. 1.2), which highlighted the importance of evaluating the new Integration Strategy and its Action Plan.

5 AB-2764, para. 3.18.

6 This was one of four strategies requested by the IDB-9 report. For the references regarding the approval, see the minutes of the Board Executive Directors (DEA/11/11).

7 AB-2764, para. 3.20.

8 GN-2653, para. 1.3.

II. CONTEXT

2.1 The Bank has accompanied the Region in the ups and downs of its regional integration process (see Box 1 and Annex B for a chronology). As the Region increased its political and economic commitment to integration, the Bank responded with increased engagement, new instruments, and policy advice. In periods when political will waned or there was a lack of consensus about the "integration paradigm" the Region should follow, the Bank reduced its engagement. The early experience of the Region in the 1960s is a clear example of increased engagement: in response to LAC presidents' calls for regional integration, the Bank took actions that ranged from creating a preinvestment fund for integration to founding an institute for studying integration issues (the Institute for the Integration of Latin America and the Caribbean, or INTAL). A similar process took place with the rebirth of integration in the 1990s when the Bank acted to regain the intellectual leadership (e.g., creating INT and reviving INTAL) and provide operational support to the integration process. Since the failure of the Free Trade Agreement of the Americas (FTAA) in 2005, it has become more difficult for the Region to agree on an integration paradigm—something that was further hindered by the commodity boom that reinvigorated the traditional trade patterns.

A. Operational aspects of trade and integration activities

2.2 Operationally, the Bank's trade and integration portfolio is roughly divided between the technical cooperation portfolio for trade, managed by INT, and the lending portfolio managed by the Infrastructure and Environment Sector (INE). The projects covered by the Integration Strategy can be broadly grouped in three categories: (i) national public sector loans to finance infrastructure projects under the major integration initiatives—Initiative for South American Regional Infrastructure Integration (IIRSA) and Plan Puebla Panamá-Proyecto Mesoamerica (PPP-PM); (ii) private sector operations with regional scope, particularly regional funds; and (iii) trade sector operations such as customs modernization or export promotion. Operationally, the infrastructure projects are designed and supervised by INE, while trade sector operations are led by INT. The private sector operations are led by the private sector windows of the Bank, particularly the Structured and Corporate Finance Department (SCF).

Box 1. Regional Integration in Latin America and the Caribbean (1960-2012)

1. The Heyday of Integration (1960-1974)

The history of integration in LAC is one of ups and downs. During the heyday of regional integration in the 1960s, countries in the Region reiterated their commitments, created the basic regional institutions—the Latin American Free Trade Association (LAFTA), Central America Common Market (CACM), Andean Community of Nations (CAN), and Caribbean Free Trade Association (CARIFTA)—and the related financial institutions (the Central American Bank for Economic Integration, or CABEI, and the Andean Development Corporation, or CAF), and called for the design and prioritization of physical integration projects. The integration paradigm prevalent in those early days (1940-1970s) was based on import substitution industrialization—the idea that, given the small size of domestic markets, a competitive industry could be developed only if countries specialized in different industries, trading the surpluses among them. That is, this paradigm called for strengthening the Region's complementarities.

2. The Integration Crisis (1975-1989)

Between the mid-1970s and the 1990s, the emergence of new national challenges and the regional debt crisis overshadowed the discussions about integration, and the integration process stalled: CACM was effectively suspended; progress toward a common market was slow; LAFTA provided limited advances and, after a long-delayed negotiation, became Latin American Integration Association (ALADI), with a less ambitious scope and without specific targets for completing the integration process;[a] and CAN was also in crisis, with Chile abandoning the group as early as 1976.

3. The Rebirth of Integration (1990-2005)

Countries' unilateral reductions of tariffs in the early 1990s paved the way for a new wave of regional integration efforts. This time regional integration was seen as a tool to help LAC economies compete in a globalized world. This "new regionalism" was not only market-oriented but was also "an integral part of the structural reform process itself."[b] More than 30 agreements were originated in the Region, and some of them even became "second-generation" agreements, in which the advantages of liberalization were related not only to trade, but also to such areas as financial integration, trade on services, investment, and intellectual property.

The Region's political commitment to integration was renewed: new institutions were created (South American Common Market, or Mercosur, and Central American Integration System, or SICA, 1991), and the old institutions were redefined to reflect new needs (CAN in 1993, CARICOM 1989-2001[c]). In parallel, the Region recognized the importance of physical integration and set up two subregional initiatives to promote the identification and financing of integration projects (IIRSA and *Plan Puebla Panamá-Proyecto Mesoamérica*, or PPP-PM).

By 2003, the Region had accomplished major advances in trade liberalization within each of the trading blocs. However, deeper integration was still needed: there remained significant nontariff barriers (technical standards, customs procedures), ample opportunities for improving the application of common customs procedures, and the need to regulate the application of second-generation agreements. Indeed, given the proliferation of agreements within blocs, it was increasingly urgent to harmonize rules of origin across free trade agreements (FTAs). A hemispheric FTA—the Free Trade Area of the Americas (FTAA)—was seen as a solution to this issue. North-South trade agreements were also considered key to the economic reform and liberalization agenda, urging Latin American economies "to pursue reforms and liberalization that have slowed or stalled in subregional agreements."[d]

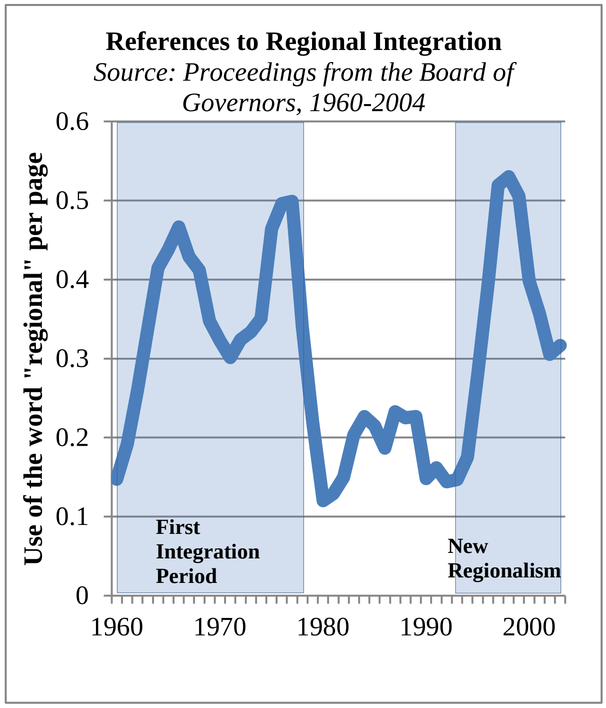
4. FTAA and the Search for a New Integration Paradigm (since 2005)

Negotiations on the FTAA finally stalled around 2003, and the deadline of 2005 for attaining a free trade area for the Americas was missed. New integration schemes emerged—Bolivarian Alliance for the Americas (ALBA) in 2004, Community of Latin American and Caribbean States (CELAC) in 2010, and Alianza del Pacifico in 2012—and some of the existing ones changed (for example, Venezuela abandoned CAF and joined Mercosur). Some of the countries of the Region pursued a strategy of bilateral or multilateral integration with the United States and Europe—for example, Dominican Republic-Central America Free Trade Agreement (CAFTA-DR) and the Caribbean Forum partnership

with the European Union (CARIFORUM-EU). The many North-South FTAs almost completed the remaining missing links in international trade, but they also increased the complexity of the situation, making the need for convergence—particularly in terms of rules of origin—all the more important.

Since the de facto end of FTAA negotiations, there is no regional consensus as to where the integration process is heading and, in particular whether the North-South agreements should be given priority in the integration agenda. Finally, since the early 2000s the Region has benefitted from a commodity boom that has reinforced the traditional trade patterns.

The changing interest in regional integration can be broadly tracked by looking at the references to regional integration made in successive meetings of the IDB Board of Governors which confirms the general narrative presented in this Box (see figure).



[a] As one observer noted, "ALADI signified the formal acknowledgement of the original project's failure." See Bouzas and Knack (2009), "El BID y medio siglo de integración regional en America Latina y el Caribe," *Integracion y Comercio*, Enero-Julio 2009.

[b] IDB (2002), *Beyond Borders, The New Regionalism in Latin America*, Washington, DC, p. 1.

[c] The Grand-Anse declaration (1989) "made the decision to transform the Common Market into a single market and economy in which factors move freely as a basis for internationally competitive production of goods and provision of services, it was also decided that for the transformation to take place, the Treaty would have to be revised." (Caricom homepage, www.caricom.org, accessed on October 15, 2012). This process was concluded with the revised Treaty of Chaguaramas establishing the Caribbean Community, including CARICOM Single Market and Economy.

[d] *Beyond Borders*, op. cit., p. 2.

2.3 The operational definition of trade and integration to be used in this evaluation includes all the projects that can be mapped to any of the three categories explained in the previous paragraph. Note that this definition is considerably wider than the definition of "transnational projects" we adopted elsewhere (RE-415); instead it resembles what the Bank has de facto considered "regional projects" under the previous integration strategy (GN-2245-1), mostly confirmed by the new Strategy (GN-2565-4). We use our own definition of regional projects because the Bank lacks a consistent classification. As we will see, Management has produced many classifications based on different databases (Development Effectiveness Matrix, or DEM, and OPUS) that are difficult to reconcile with the Bank's own baseline lending of 10%. To avoid confusion, we have constructed our own classification that maps the different interventions covered by the Strategy and is able to replicate the baseline of 10% established in the IDB-9 Agreement (AB-2764). It is important to highlight that this is a positive definition and should not be construed as OVE's definition of what a "regional integration

project" should be. As we will see below, many of the projects included in our definition do not have any discernible regional contribution.

2.4 INT has historically been responsible for nonlending operations. From the outset, INT's mandate focused on technical assistance and other nonlending activities, particularly analysis and study of the integration processes and the training of public officials in the Region (Annex C describes the evolution of INT's mandate). Indeed, INT essentially managed the regional technical cooperation of the Bank, primarily financed by net income from the Fund for Special Operations (FSO).[9] From 2000 to 2010, INT managed 450 technical cooperation operations—roughly 41 per year—and just 21 loans, or 2 per year. Thus INT manages about 22.5 technical cooperation operations per lending operation, by far the highest figure of all the operational departments of the Bank. This preponderance of nonlending work has implications for staffing and, crucially, budgetary allocations, which mostly depend on the number of loans being prepared and supervised.[10] Finally, INT has managed an almost negligible part (about 5%) of all the loans approved for trade and integration. Trade loans were early on approved under the sector facility for trade and, more recently, as investment operations.[11] They were concentrated in customs improvement and export promotion.

2.5 A large majority (75%) of the "trade and integration" projects for 2000-2012 are national loans (particularly in transportation) made under the two regional initiatives (IIRSA and PPP-PM). Although the Bank has repeatedly attempted to define criteria to identify regional projects, as of 2012 it still does not apply any specific criteria to the identification of regional projects. As OVE has repeatedly found in the past, the operations financed under the IIRSA and PPP-PM frameworks are no different than a typical national infrastructure project: they are neither designed nor executed differently than national operations. Although national projects can contribute to regional integration, this link cannot be automatic. At a minimum, the Plan of Operations should contain an argument to that effect. For instance, national trade loans can be argued to have a regional integration contribution. So can national loans designed and executed in coordination between different countries (for instance, the Lempa River Basin project). However, as said above, these cases are exceptions rather than the rule: currently the Bank automatically considers projects related to "integration initiatives" as regional, even when these are national projects, designed and executed nationally, and without any explicit link to regional (see Box 2).

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9 See RE-415 for more details.

10 See VPS's "Guide for definition, allocation and management of the budget for preparation and supervision of 2011 operations," accessed from VPS intranet (http://vps) on October 15, 2012.

11 Looking at the projects approved between 2000 and 2012, 9 were approved under the sector facility, 12 as specific investment operations, 1 as an innovation operation, and 1 under the project preparation facility.

Box 2. What constitutes a Regional Project?

The haphazard application of the word *regional* in the Bank has led to some paradoxical cases in which projects without any demonstrated or even plausible regional integration contribution have been labeled as regional integration projects.

The Rodoanel projects in Brazil (BR-L1228, approved in 2008 for the western section, and BR-L1296, approved in 2011 for the northern section) have been sometimes classified by Management as "regional projects," presumably as they belong to the IIRSA umbrella. The first project was intended to finance the concession fee and the upgrade and expansion works of the 32-kilometer west section of the São Paulo beltway—the Rodoanel. The second project dealt with the construction of the northern section of the Rodoanel. The beltway is expected to eventually surround the entire city of São Paulo to better distribute traffic flows across the metropolitan region and reduce the traffic congestion in central São Paulo. Among the benefits of the project are the reduction of traffic delays and related costs, and the reduction of greenhouse gas emissions from vehicles that would otherwise be in stop-and-go traffic. The development outcomes further include business performance, contribution to economic development, environmental impacts, and private sector development. This project received special attention in the 2011 Development Effectiveness Overview (GN-2607-2, p. 58) which stressed the important national benefits but failed to identify any regional benefit.

Similarly, in 2006, the IDB approved a loan of US$580 million to finance a 1,220km-500kV electric power line that links the northwest and northeast regions of Argentina. The main purpose of the project was to strengthen the national electric power transmission grid to encourage competition in the wholesale generation market. None of these objectives is immediately linked to regional integration. In particular, the newly constructed electric power line is meant to increase the interconnection of the Argentine electricity grid. In this sense, the logical framework does not include transnational purposes. On the contrary, it clarifies the national nature of the project all along: the main goal is "to contribute to sustainable *national* socioeconomic development," while the main purpose is "to strengthen the *national* electric power transmission grid" (PR-3064, emphasis added).

These projects may have relevant national benefits for each of the countries, but they are hard to reconcile with the Governors' mandate of regional integration. In both cases the Bank has failed to explain what—if any—the regional benefits are. This is not a problem of the projects themselves, which may well have high national benefits and be aligned with the individual Country Strategies; it is rather a problem of the Bank.

2.6 Some 20% of the portfolio corresponds to operations with regional benefits, including a number of private sector operations (regional funds). These operations tend to be mechanically identified as "regional" because their benefits are not associated with specific countries and all countries can tap into their funds. However, most of them do not even target challenges that are regional (e.g. fund for small producers in Latin America, RG-L1029; Sugar and Bio-Energy Fund, RG-L1019; and Developing the Base of the Pyramid, RG-L1040). We will not consider them further.

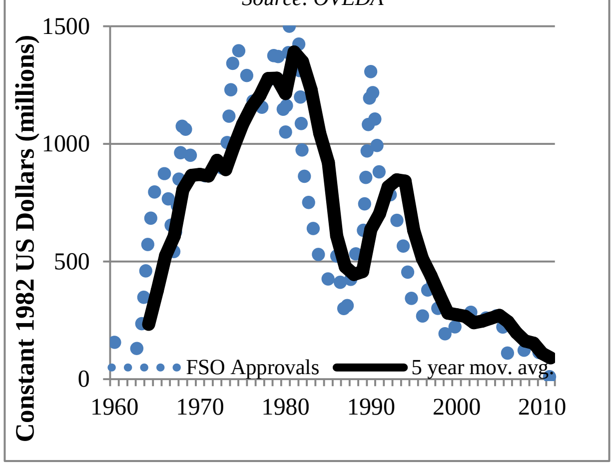
2.7 As OVE noted in a recent evaluation (RE-415), between 2000 and 2012 only two infrastructure integration operations have had a clear link to cross-border externalities. The flagship transnational project of the Bank has been the transmission line that connects all the Central American countries (Central American Electrical Interconnection System, or SIEPAC, CA007/CA0035). Another program improved the management of the trinational basin of the Lempa River (CA0034). In both cases the loans were national, but the programs were

conceived in a unified and coherent transnational framework. The experience of the Bank in these two regional integration operations indicates that projects with cross-border externalities take longer, are costlier, are more vulnerable, and are unlikely to happen unless there is concessional financing to overcome these challenges. Indeed, in both of these cases the Bank managed to secure ad hoc concessional resources from bilateral donors (see RE-415 for more details on both programs). The Bank's experience is in line with the experience of the World Bank, the African Development Bank, and the Asian Development Bank, which all experience limited demand for multinational projects unless they increase the concessionality of the loans.

B. Bank resources

2.8 Bank lending in the area of integration is mostly carried out through ordinary capital, although transnational projects were eligible for FSO financing. Created by the Bank in 1959, the FSO was the first concessional window ever created by a multilateral development bank (MDB). It was "established for the making of loans on terms and conditions appropriate for dealing with special circumstances arising in specific countries or with respect to specific projects" (Charter, Article IV, Section 1). Indeed, during the 1960s and 1970s, the FSO financed 68% of all the regional integration loans of the Bank, which included mainly operations with the subregional development Banks (CABEI, CAF, and the Caribbean Development Bank). In 1972, eligibility for FSO financing was explicitly extended to projects with cross-border externalities (AB-303-3), although this provision was never effectively implemented: starting in 1982, FSO eligibility was progressively restricted to specific countries rather than specific operations.[12] (Figure 1 illustrates the decline in FSO loan approvals.) Without access to the FSO or other concessional funds, the Bank has had limited success at providing incentives for projects with regional benefits (e.g., transnational projects) (see Box 3).

Figure 1. Overall FSO Loan Approvals, 1960-2011
Source: OVEDA



12 In addition to transnational projects, which are eligible for FSO financing, two types of trade and integration projects have been financed from ordinary capital: an "export financing" line that financed the intraregional trade in capital goods during the 1960s and 1970s, and a few binational regional projects (e.g., Yaciretá) in the 1970s.

Box 3. The Quest for a Lending Instrument for Transnational Projects

The Bank has always intended to carry out transnational projects involving two or more countries. Early in the Bank's history, the Bank's President stressed that "our action will certainly be directed toward the framing and financing of regional development plans covering two or more countries."[a] Indeed, not only does carrying out transnational projects match the aspirational objectives of the founders of the Bank, but there is a good theoretical reason why MDBs should engage in transnational projects: the presence of cross-border externalities and the limited national benefits make it unlikely that countries would want to carry them out on their own, but the presence of an honest broker can help the countries coordinate and reach agreement on a mutually acceptable distribution of costs according to the expected benefits. But while the development impact of transnational projects is potentially high, there are also high costs attached to them (see RE-415).

Throughout its history the Bank has created different windows to tackle the issues of transnational projects, particularly large infrastructure integration projects. A preinvestment fund for Latin American integration (PFLAI) was created in 1966, and a similar fund was created in 2005: Fund for the Financing of Technical Cooperation for Initiatives for Regional Infrastructure Integration (FIRII). Both the PFLAI and the FIRII anticipated that countries would be willing to borrow—at least on a contingent recovery basis—to carry out the preinvestment work for projects that have significant cross-border externalities. As it turned out, there was virtually no demand for the reimbursable funds of PFLAI or FIRII, although there was ample demand for nonreimbursable funds. As a nonreimbursable modality had not been conceived for FIRII, it was necessary for the Board to change the objectives and criteria of the Fund to make it operationally relevant.

Under the assumption that the main constraint to developing transnational projects was the IDB's lengthy approval processes, in 2003 the Bank created a facility to simplify the approval of such projects. As it turned out, this diagnosis was also incorrect. Only one project—a border crossing project for Peru—was ever approved under the sector facility for transnational projects. The sector facility did not give any preferential treatment to borrowing countries in terms of financial terms or maturities. Eventually, the reform of the Bank instruments in 2011 eliminated sector facilities (GN-2564-3).

Annexes D and E provide additional information.

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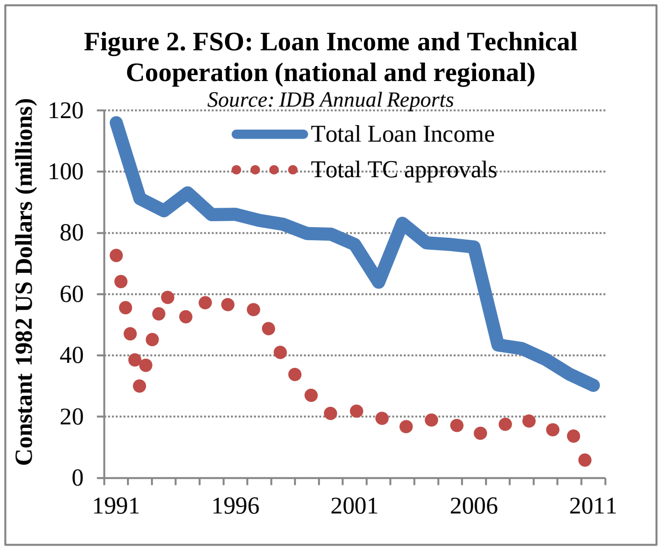
[a] Proceedings of the Second Annual Meeting of the Board of Governors, 1961.

2.9 Besides limiting the opportunities for financing regional projects, the depletion of the FSO jeopardized the Bank's Regional Technical Cooperation (RTC) program, which was historically financed from the net income of the FSO. The progressive reduction of available FSO funds—crucially aggravated by debt relief efforts on the order of $5 billion that took place between 1998 and 2006—drastically reduced the outstanding balances of FSO and, thereby, its income. In consequence, RTC's annual financing was first reduced from about US$30 million (1994-1998) to US$10 million (2000-2010). It was stopped altogether in 2011 (see Figure 2). As of October 2012, the IDB-9 mandate that "funding for the

non-reimbursable technical cooperation [be] transferred to the [ordinary capital]" is not yet completed for RTCs (AB-2764, 3.26).[13]



2.10 The progressive reduction of available resources for RTC was partially offset by the creation of two special ordinary capital programs and two multidonor funds since 2004. The Regional Public Goods (RPG) initiative (GN-2275-5) financed small interventions that promoted regional cooperation and functional integration; between 2005 and 2011, US$10 million per year was assigned to this initiative, but in 2012 the annual allocation was reduced to US$5 million. Since this window funds programs through a competitive process, it has faced significant challenges focusing its interventions for a strategic use of its resources.[14] This initiative was complemented by the FIRII, originally approved in 2005, and currently endowed with about US$15 million for financing preinvestment studies (see Annex D). In 2011, Management proposed the creation of a multidonor trust fund to complement the FIRII, the FIRII+ (OP-590); as of October 2012, FIRII+ has US$14.5 million. Finally, in 2008 the Bank also created a trade-related Aid for Trade trust fund to help borrowing member countries "strengthen their capacity to integrate into the global economy and to benefit from liberalized trade and increased market access" (OP-165). Aid for Trade received a contribution of US$1.8 million in 2012 and currently has US$6.4 million available.

2.11 In sum, as of 2012, the Bank has no effective instrument to deal with the increased costs of regional integration projects, something that can explain why it has resorted to assigning national operations, designed and executed nationally and not coordinated regionally, as regional integration projects. In 2012, the quest for a financial instrument that addresses projects with regional benefits remains largely on the drawing board. Although the Bank has in the past attempted to create such instruments (see Box 3), it has systematically failed to address the key

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13 According to the last concessional agreement, four national (National TCs, Action Plan C+D, SEP, CT/INTRA) and one regional program were being financed from FSO net income (CA-474). During 2011, Management created the Small and Vulnerable Countries program (GN-2616-1) with two windows, one to replace the FSO-financed National TCs and the other to replace the Action Plan C+D. The MIF's Social Entrepreneurship Program was transferred to the OC Social Entrepreneurship Fund (GP-75-11) and the CT/INTRA, fund was transferred to the OC-financed CT/INTRA. The FSO-financed RTC program has not yet been transferred to any OC fund.

14 See OVE's recent evaluation of the IDB's transnational programs (RE-415).

issue: making loans more attractive for borrowers to compensate them for the increased costs.

2.12 In spite of statements supporting regional integration, the resources the Bank devotes to technical cooperation for regional integration have been significantly reduced lately. With the concessional reforms of 1998 and 2006, the amounts available for technical cooperation have dwindled and the Bank has only partially offset this effect with the creation of new ordinary capital programs (FIRII, RPG). As of 2012, there is a stock of about US$60 million to finance preinvestment and technical assistance for trade and integration projects in the next five years.[15] This would translate into approvals of some $12 million a year, assuming no new replenishments come before then. Although it is not easy to say whether these amounts are commensurate with the Bank's goals, it is clear that they are significantly lower than in the past (e.g., RTC approvals in 1994-1998 averaged US$28 million per year, or US$40 million at current prices)

15 This comes from summing the availabilities of the funds (FIRII, FIRII+, Aid for Trade), which is US$35 million plus US$25 million for RPGs (US$5 million a year for the next five years). Since FIRII and FIRII+ have recently been replenished, we assume no other replenishment in the next five years. These are indicative assumptions with the sole purpose of getting a sense of the overall order of magnitude. Note that in the very recent 2013 budget proposal, an overall allocation of US$ 8.5 for the integration cluster is included, with US$8 million for RPG and US$0.5 million for FIRII (GA-252-7)

III. FINDINGS

All men can see these tactics whereby I conquer, but what none can see is the strategy out of which victory is evolved.

Sun Tzu, "The Art of War"

3.1 A strategy can be broadly defined as a plan that links some objectives with specific decisions in the future. Strategies do not need to be written or even to be explicit; at a minimum, a strategy could be defined as "a pattern in a stream of decisions."[16] The literature varies on exactly what key components a strategy paper should have; but most agree that two essential components are the capacity to guide action and the internal coherence of these actions. In evaluating the Bank's Strategy for regional and global integration, this paper looks at whether it (i) contains a **diagnosis** of the situation and identifies opportunities; (ii) identifies of the **goals** to be achieved; (iii) outlines a specific course of **action** that would lead to the achievement of the goal, including a discussion of alternatives and the rationale for the path chosen; and (iv) includes appropriate **verification mechanisms** (e.g., baselines, indicators, supervision structure) as well as a discussion of the risks and mitigation measures.

A. Diagnosis

3.2 The Strategy has a complete and lengthy diagnostic focusing on the "New Regionalism" and regional developments since the 1990s. Briefly, since the 1990s a drastic reduction in tariffs (para. 4.3) and the almost universal coverage of bilateral trade agreements (para. 4.4) have intensified the complexities regarding rules of origin (para. 4.5). According to the Strategy, LAC should now focus on closing both global and regional "integration gaps." The Strategy proposes closing the global gap by ensuring low tariffs relative to the rest of the world (para. 4.10). Closing the regional integration gap will require making the Region more interconnected (para. 4.11) through investments in *hardware* (e.g., infrastructure) and *software*—policy and regulatory frameworks (para. 4.12). Indeed, the recurring theme of this Strategy is the complementarity between hardware and software (para. 1.5), which it argues has a large return relative to investing in either software or hardware alone (para. 4.22). The Strategy then

16 There is an extensive literature on strategies. It is not the objective of this paper to delve into the technical definition of a strategy, and the definition is included simply to orient the reader. Some classical references for strategies are Mintzberg, Henry (1978), "Patterns in Strategy Formation," *Management Science* 24 (9): 934-948; Mintzberg, Henry (1987), "Crafting Strategy," *Harvard Business Review*, July-August; Porter, Michael E. (1996), "What is Strategy?" *Harvard Business Review*, November-December, pp. 61-78; Collis, David, and Rukstad, Michael G. (2008), "Can you say what your strategy is?" *Harvard Business Review*, April. The quotation on strategy as a "pattern in a stream of decisions" comes from Mintzberg, 1978.

provides more detail on the kinds of software and hardware investments to be made (paras. 4.13-4.21).

3.3 The rationale for integration presented in the Strategy is based almost exclusively on economic considerations: “Integration is not an end in itself, but a strategic platform to maximize the benefits of globalization and harness functional cooperation for growth and development” (para. 3.1). The Strategy then focuses on the economic benefits of integration as an engine of growth and development (para. 3.2) and a platform for functional cooperation—including increasing the Region’s bargaining power in international trade fora (para. 3.3). Although these arguments sound plausible and sensible, some of the supporting statements are not sufficiently justified. For example, the causal link between foreign direct investment (FDI) and growth has been subject to much debate in the literature and is far from settled.[17]

3.4 More importantly, the stated rationale for integration entirely overlooks political aspects, which are essential to the success of any integration process. LAC countries’ strong political support for integration in the 1960s was crucial both to inspire policymakers in the Region and to get countries to actually commit effort and resources. It was because of this strong political support that IDB took important measures to foster regional integration during its first two decades: for example, creating an export promotion credit line, a preinvestment facility for infrastructure integration, an institute for the study of Latin American integration, and extending the eligibility of FSO to cover transnational projects. Indeed, in assessing the experience of the IDB in terms of regional integration, President Enrique Iglesias noted that a “sustained political vision and a firm regional leadership are the key ingredients of a successful regional integration.”[18] Furthermore, the experience from other integration processes—and, crucially, the experience of the EU—indicate that the political impetus is what catalyzes any successful integration process, and that economics comes afterwards.[19]

3.5 Without strong political commitment, the integration mandate translates into mere wishful aspirations. In that sense, integration is indeed an end in itself, as well as the catalyzer of a broader economic process. Political will in the Region should not be construed as a mere “precondition” to integration (para. 3.4), but rather as a central theme of the Bank strategy. Indeed, IDB—with its multilateral nature and long-term focus—has a potentially unique role in helping the LAC countries to

[17] See, for example, Hansen, Henrik, and Rand, John (2006), “On the Causal Links between FDI and Growth in Developing Countries,” *The World Economy* 1 (1): 21-41.

[18] Iglesias, Enrique V. (2001), “Doce Lecciones y Cinco Décadas de Integración Regional en América Latina,” in *Integración y Comercio* 5 (13): 140.

[19] See, for instance, Dinan, Desmond (2007), “Fifty Years of European Integration: A Remarkable Achievement,” *Fordham International Law Journal* 31 (5): 1118-1142. In particular, Dinan describes the political motivations of the European Coal and Steel Community—a predecessor of the EU—and notes that “the importance of the Coal and Steel Community was more political than economic” (p. 1124).

maintain the long-term vision of integration. The role of the Bank as an honest broker in the Region is highly relevant now, when there is limited consensus about the future of the integration process (see Box 1). In sum, building political will for integration is an opportunity—as well as a challenge—for the Bank.

3.6 In spite of the asymmetric consideration of political challenges to integration, the Strategy's trade diagnostic is in general sound, with a logically structured assessment of trade in LAC. It is consistent with the Bank's previous integration strategy (GN-2245-1), to which it adds a useful update on the failure of FTAA and the proliferation of North-South trade agreements that followed. In sum, the new Strategy provides a sound analysis based on a consolidated literature, which has been produced in no small part by INT.[20]

3.7 However, the Strategy's diagnosis of infrastructure integration in Latin America is weak, consisting of a casual reference to the low coverage and quality of the existing infrastructure (particularly the road network) (para. 4.18). Given the Bank's strong participation in infrastructure integration initiatives since 2000 (IIRSA/PPP-PM), a thorough appraisal of the progress and challenges after more than a decade of such initiatives would have been revealing. The Strategy also fails to quantify LAC's infrastructure integration needs, something that would inform the Bank's own approach to infrastructure integration.[21] Ultimately, the Strategy lacks a full discussion of whether and why investment in infrastructure integration, as opposed to national infrastructure investment, is needed. There is some discussion of the lessons learned from Bank engagement in infrastructure projects (paras. 5.10-5.13); but such a discussion does not substitute for a thorough diagnosis. The limited diagnosis of infrastructure integration is particularly worrisome because almost three-quarters of the portfolio covered by the Integration Strategy is in the form of infrastructure projects, with only 5% in the form of trade projects.

3.8 Finally, the background for non-trade cooperation—or functional cooperation—could have been strengthened. The treatment of regional public goods in the strategy is limited to three loosely connected paragraphs (paras. 4.23-4.25) that fail to identify specific regional and global public goods the Bank may want to prioritize (e.g., shared river basins, transnational crime, biodiversity).

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20 See, for instance, Devlin, R., and Giordano, P. (2004), "The Old and New Regionalism: Benefits, Costs, and Implications for the FTAA," in Estevadeordal, A., Rodrik, D., Taylor A.M., and Velasco, A., *Integrating the Americas: FTAA and Beyond* (Cambridge: Harvard University-David Rockefeller Center for Latin American Studies); Estevadeordal, E., Frank, B., and Nguyen, T. (eds). (2004), *Regional Public Goods: From Theory to Practice*, (Washington, DC: IDB-Asian Development Bank); and IDB (2002) *Beyond Borders*, op. cit. One background paper for the Strategy that is particularly useful is IDB (2011), *Investing in Integration: The Returns for Software-Hardware Complementarities*, Integration and Trade Sector, Note IDB-TN-265, Link

21 This is something that the Bank did in the past. For instance, the inventory of regional projects identified projects for an equivalent of US$60 billion in 1972 (see Annex D).

B. Objectives

3.9 It is difficult to establish objectively what the mandate from Governors regarding regional integration is, as it differs substantially between (i) the Cancun Declaration (AB-2728), ii) the IDB-9 Report (AB-2764), (iii) and the IDB-9 Report annexes. The original mandate from Cancun is very clear in stating that the priority of the Bank is exclusively "regional integration," following a long tradition in the Bank's capital replenishments (Annex A). The main body of the IDB-9 Report goes in the same direction: Governors identified "the knowledge and capacity to support regional trade and integration" as a main comparative advantage of the Bank. They even stressed the importance of the Bank's technical cooperation program over its comparators (World Bank, footnote 11) and noted the more limited research and policy support capacity of oher comparators (footnote 12 and Table III-1). In paragraph 3.17,[22] there is a detailed account of all the trade challenges and emerging needs in the Region. Here again, the Governors' mandate focuses on trade issues and mostly on a software and nonlending agenda. In sum, both the Cancun Declaration and the main text of the IDB-9 show a clear mandate to support regional integration in much the same way as past capital increases, stressing the role of technical assistance and nonlending activities.

3.10 However, in other—often ancillary—documents,[23] Governors refer to activities that are substantially different from the regional integration priority described in the main text and in the Cancun Declaration. In particular, they propose to engage in "large-scale regional public goods," "coordination of operations with cross-border externalities," and "multi-country infrastructure projects" (Table III-2). Furthermore, in a break with history, the IDB-9 Report renames the "regional integration" priority as an all-encompassing "competitive regional and global international integration" (3.17, AB-2764). The reasons for expanding the scope to "global integration," or what exactly is the meaning of "competitive" in this context, remain obscure. The annex does, however, provide a very clear roadmap for actions, and lists five main areas, of which only two, infrastructure and regional initiatives (IIRSA,PPP-PM) have significant lending volumes (the other three are related only minimally, if at all, to lending, e.g., RPGs). The IDB-9

22 Specifically, the IDB-9 discusses the sector priority of "Competitive regional and global international integration" in para. 3.17: "Since the late 1980s and early 1990s, the LAC region has begun to pursue a dynamic multipolar economic integration strategy. Over the past two decades, most countries have signed and implemented multilateral and regional trade agreements or have pursued unilateral commercial liberalization. Despite considerable progress, trade performance in LAC is still lackluster compared with Organization for Economic Co-operation and Development (OECD) and Asian developing countries. Investments in areas such as the administration and harmonization of rules of origin, customs procedures, sanitary and technical standards, and upgrading trade-related institutions are needed to take full advantage of the benefits of opening markets. In addition, the Bank should expand this traditional agenda to include new issues associated with trade in services, such as technical know-how and financial flows, and it should design convergence" (AB-2764).

23 Table III-2 (partially) and Annex 1 (GN-2764).

annexes seem to depart significantly from the original mandate of regional integration, widening it to "global integration" and placing an emphasis on infrastructure that is not commensurate with the limited treatment of infrastructure integration in the main body of the IDB-9 Report. In sum, the priorities regarding regional integration seem to differ substantially between the "Cancun Declaration" and the IDB-9 Report.

3.11 The recurring theme of the Integration Strategy is the concept of "software-hardware" complementarities—that is, that all the activities have to be carried out within the "software-hardware continuum." The Strategy identifies three thematic areas: software, hardware, and functional cooperation and regional public goods.

- Software priorities include (i) negotiation and implementation of new trade and investment agreements, (ii) export promotion, (iii) trade facilitation and customs modernization, (iv) promotion of the private sector in trade activities and infrastructure finance, and (v) generating an enabling environment for integration (para. 6.5). All of these loosely match the Governors' mandate and INT's scope of action; in these activities the main value-added comes from the technical expertise of INT, and it is mostly unrelated to lending operations (see Table 1).

- The priorities for hardware investment are aimed at increasing competitiveness in general without explicit references to integration. The main areas of action are (i) transport connectivity, (ii) energy investment, and (iii) telecommunications and information and communications technology. Although the Strategy claims to deal only with the cross-border aspects of infrastructure development (footnote 32), most of the areas suggested for Bank action do not affect cross-border issues (e.g., "upgrade the quality and expand the coverage of national transport routes, connecting them to the main trade hubs"). It is unclear why these aspects should be discussed in the Integration Strategy, rather than in an infrastructure strategy. These priorities are closely tied to the terms of reference of INE.[24]

- Regarding functional cooperation, though it is mentioned in the text (para. 6.7), there are no specific priorities but rather a general call to "projects that

[24] "The Infrastructure and Environment Sector (INE) conceptualizes, prepares, supports the execution and supervises the IDB's operations related to energy, transport, water, sanitation, rural development and natural disasters and climate change. INE is divided in the Sustainable Energy and Climate Change Unit, Energy Division, the Transport Division, the Environment, Rural Development and Disaster Risk Management Division, and the Water and Sanitation Division. The sector works with the country departments to design and execute country and regional financial and non-financial programs and projects and evaluates the development results of such interventions. It also performs quality enhancement functions for social development projects and programs, to include guiding, designing and preparing Bank's products' execution, and analysis and mitigation of risks." From INE's intranet http://ine, accessed on October 15, 2012.

focus on areas of intervention where regional collective action adds value to national interventions and where the Bank has a comparative advantage."

3.12 Overall, both the software and hardware priorities identified in the strategy closely map the Bank's previous areas of engagement, as Table 1 illustrates. That is, everything that the Bank has been doing in the last 12 years appears as a priority in the Strategy, revealing a pattern of continuity rather than change. However, according to some leading authors in the literature, one of the most important elements of a strategy is the need to make explicit trade-offs:[25] in this Strategy, except for the emphasis on lending for trade issues (which is not new as we discuss below), there seem to be very few trade-offs. In sum, the Bank's proposed priorities reveal both continuity and limited strategic positioning. (See Annex F for the mapping of the priorities and the technical cooperation approvals.)

Table 1. Type of Priority

Type of intervention	Description (GN-2565-4)	Type of instrument	Lending, 2000-2012[b]	Main responsible unit
Software para. 6.5.i	Negotiation and implementation of trade and investment agreements	Regional Technical Cooperation (RTC)	Combined loans for US$226 million. (4 %)	INT
Software para. 6.5.ii	Export promotion and investment attraction	RTC and some loans		
Software para. 6.5.iii	Trade facilitation and customs modernization	RTC and some loans		
Software para. 6.5.iv	Expansion of the depth and coverage of private finance[a]	RTC and private sector lending	US$653 million (11 %)	SCF
Software para. 6.5.v, 6.7	Development of an enabling environment for sustainable and inclusive integration	RTC, Regional Public Goods Initiative, Regional Policy Dialogue	No lending	INT
Hardware para." 6.6. i	Connecting the transport network	Public/private sector lending	US$3,240 million (56 %)	INE
Hardware para. 6.6. ii	Supporting cost-reducing energy integration	Public/private sector lending	US$1,598 million (27 %)	INE
Hardware para 6.6. iii	Bridging the digital divide	Public/private sector lending	No lending	INE

[a] Includes private sector operations (e.g., trade financing).

[b] The percentages in the column add only to 98% because of rounding error and the exclusion of a few projects that do not fit into any of the categories (0.4%).

1. Comparative advantages

3.13 The Strategy correctly identifies the major comparative advantages of the Bank: (i) its intellectual leadership, particularly in trade issues, and (ii) its role as an honest broker in the Region, promoting a long-term vision of trade and regional integration (paras. 5.6, 5.8). These comparative advantages are consistent with

[25] See Porter, op. cit., who distinguishes between operational efficiency—i.e., doing better something we know how to do—and strategy—positioning oneself in new markets.

INT's long history of engagement in policy advice and regional technical cooperation and with the widely acknowledged technical capacity of INT staff.

3.14 However, it is difficult to link the comparative advantages of the Bank with the increased emphasis on lending for trade issues. The identified comparative advantages have more to do with the Bank's "nonlending" side. Mostly missing from the Strategy are such key questions as, What is the obstacle to the Bank's lending in trade issues (a strategic goal since 2003)? Are the Bank's structure and incentives in line with lending for trade? and Would countries actually demand that type of support? In sum, although there are scattered mentions of the Bank's comparative advantages, they are not useful in assessing whether the strategic decision of lending for trade issues is reasonable or doable.

2. Lessons learned and challenges

3.15 The Strategy contains a protracted—albeit not entirely useful—discussion of the lessons learned from the Bank's past engagement. The discussion focuses on the Bank's achievements in each of the fields covered by the Strategy. There are very few "lessons learned" in the sense that they reflect empirical knowledge that is operationally relevant, factually correct, and applicable for the future design of operations.[26] Many of the statements are impossible to verify (e.g., references to technical cooperation work being "highly valued" by the clients). Most notably, almost all the lessons learned identified do not have clear, relevant operational implications (e.g., "The Bank learned that the convening power of the Bank is crucial to raise awareness"). A notable exception is the references to the lessons learned from the RPG program, for which the text outlines both the lessons learned and their operational implications (para. 5.10). Finally, some paragraphs refer to lessons learned but contain no specific "lesson" (paras. 5.4 and 5.5). (Annex G provides greater detail on the lessons learned discussed in the Strategy.)

3.16 In addition to the lessons learned, the Strategy correctly identifies the main challenges of working regionally. There is wide evidence from the literature that working regionally is costly, riskier, and more difficult for both the Bank and the

26 Lessons learned were developed by aeronautical and space agencies where experience crucially informs operation. There are many definitions: a complete one could be: "A lesson learned is a knowledge or understanding gained by experience. The experience may be positive, as in a successful test or mission, or negative, as in a mishap or failure. Successes are also considered sources of lessons learned. A lesson must be significant in that it has a real or assumed impact on operations; valid in that is factually and technically correct; and applicable in that it identifies a specific design, process, or decision that reduces or eliminates the potential for failures and mishaps, or reinforces a positive result." Secchi, P., Ciaschi, R., and Spence, D. (1999), "A Concept for an ESA Lessons Learned System," in Secchi, P. (ed)., *Proceedings of Alerts and LL: An Effective Way to Prevent Failures and Problems* (Technical Report WPP-167), Noordwijk, The Netherlands, ESTEC, pp. 57–61.

countries.[27] The Strategy takes some of these issues into consideration. At a national level, the paper briefly discusses the potential asymmetries of costs and benefits (para. 4.23), the inherent difficulty of coordinating countries (para. 6.17), and the high vulnerability of regional projects to lack of political will (para. 6.20). The Strategy is somewhat weaker in the its discussion of the internal Bank challenges of working regionally: working across the dimensions of the Bank matrix (countries, sectors); the lack of staff incentives related to the high transaction costs of regional operations (e.g., long maturity periods and difficult operations); and the weak connection between the lending and the regional technical cooperation programs. Furthermore, the final version of the Strategy does not consider the need to develop new instruments to compensate for these challenges, although it was identified in an earlier background paper (GN-2565, para. 6.13). These challenges are in line with OVE's past recommendations (see Box 4).

3.17 The Strategy's emphasis on the challenges of working regionally and carrying out regional projects is unmatched by a strategic approach. In the IDB-9 document, Governors give an implicit mandate to work on a regional lending program.[28] The Strategy indeed mentions at length the challenges of working regionally, and these challenges feature prominently in the risk assessment (see below). But it is noteworthy that no specific guidance or actions are discussed regarding the regional lending program. In particular, it would be useful to have a candid discussion of the extent to which the Bank can create a regional lending program using a "smart-mix" of existing instruments. For all intents and purposes, the only specific action that is to be found in the strategy is "proactive programming." Given the "country-focus" enshrined by the Bank's realignment (GA-232-8), OVE is unsure as to the effectiveness of this approach.

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27 See OVE, RE-415, for a discussion and for more extensive reference. See also the evaluation from the World Bank: IEG (2006), *The Development Potential of Regional Programs*. On the operational aspects, a report by the World Bank Quality Assurance Group on regional programs noted all the challenges of these operations (World Bank, "Regional Projects: A QAG Learning Review," March 17, 2010). Finally, the recent report of the Operation Evaluation Office of the African Development Bank ("Fostering Regional Integration in Africa: An Evaluation of the Bank's Multinational Operations, 2000-2010") also notes the pervasive incentive misalignment and the lack of a business model to deal with regional operations.

28 Indeed, Governors signal areas of ongoing involvement and areas of future development. There are seven areas of development, four of which are for the traditional "trade" activities, mostly nonlending. The other three (multicountry infrastructure projects; coordination of national sovereign operations featuring cross-border externalities; large-scale regional public goods) refer specifically to "regional" lending.

Box 4. OVE Recommendations Regarding Regional Integration Projects

In the last five years, three OVE evaluations have mentioned the need to create new financial instruments for regional work and new methodologies to assess the regional contribution.

Evaluation of IIRSA, 2008 (RE-338)

"**Tailor new products and programs to the particularities and needs of integration infrastructure projects.** Specifically, OVE recommends the launch of discussions, innovation, and development of the following instruments:

- "Financing vehicles and economic evaluation methodologies with which to address asymmetries among the countries and distribute integration infrastructure project costs, benefits, and risks accordingly.
- "Actuate nonlending products and horizontal cooperation modalities to bolster technical consensuses among the IIRSA member countries and the institutional capital of the regional infrastructure integration process.
- "Develop programs that target funding to key integrating projects such as border crossings, ports, and associated logistic services, to strengthen consensuses around the Integration and Development Hubs."

Evaluation of Plan Puebla Panama, 2009 (RE-350)

"**The Bank should improve its internal capacity to support the PPP.**

- "The Bank should develop financial mechanisms aimed at supporting regional projects that mitigate the larger transaction costs pursued by these regional projects when compared with the national projects."

Evaluation of Transnational Programs, 2012 (RE-415)

"**Recommendation 2: If the Bank decides to deepen its commitment to transnational projects, take needed steps to that end**:

- "Identify ways to enhance the concessionality, and if possible availability, of project funding to offset borrower disincentives and reduce the effective cost of transnational operations. One possibility would be to earmark a specific amount of FSO from the next replenishment in order to finance blended loans for projects that can show significant cross-border externalities. Other alternatives include interest-rate subsidy schemes (e.g., an intermediate financing facility) or the use of grants. The Bank should also explore the feasibility and risk-implications of concessional lending to regional institutions without sovereign guarantee.… Even if it is not possible to increase concessionality, the Bank could earmark resources from [ordinary capital] to finance regional projects. This could increase countries' incentives to engage in transnational projects—especially for countries with small lending envelopes at the national level."

C. Actions

3.18 The Strategy proposes to shift the Bank's focus toward lending activities while increasing coordination within the Bank. Reflecting the diagnosis and the goals, the Integration Strategy interprets the Governors' mandate as calling for three major "changes in focus": (i) **increase in scope**—from regional only to regional and "global" integration; (ii) **change in operational modalities**—moving from technical cooperation to lending (this focus implicitly refers to the portfolio part

that corresponds to INT, which led the exercise of writing the strategy); and (iii) **increased coordination** among units in the Bank (para. 5.2).[29] Although Governors probably meant that integration activities should be more coordinated within the Bank—as should any other cross-sector priorities such as climate change or gender—the mandates offer is no specific instruction regarding coordination. This seems a reasonable choice of Management, given the historic divorce between nonlending (INT) and lending (INE) activities. Regarding "mainstreaming" lending, the language used in the Strategy is difficult to comprehend: regional integration already has a lending program (mostly infrastructure), which served as a baseline for the IDB-9 lending target; even INT has received a lending mandate since the realignment (see Annex C); and even before that, the Integration Strategy of 2003 (GN-2245-1) indicated that the Bank intended to go in that direction. Moreover, the discussion of integration in the Governors' mandates makes no explicit mention of the financial instruments to be used in integration projects—let alone the need to "mainstream" integration. Finally, as indicated above, Governors renamed their "regional integration" mandate as "competitive regional and global international integration," although they provided no guidance on what they mean by it or what the implications of those changes are. Irrespective of the potential merits of the "changes of focus" that Management intends to pursue, it is not clear to OVE how these stem the from Governors' mandate; with the possible exception of "global" integration, which is indeed mentioned in the document. However, these changes seem to be broadly related to the Integration Strategy's own goals.[30]

3.19 The Strategy provides very limited information to assess whether the objectives are commensurate with the available means. It does not define what the current trade and integration portfolio is or whose the operational responsibilities are. It does not indicate what resources are currently available and the approximate amounts that will be available for the duration of the Strategy. It does not discuss the appropriate mix of grants and loans to achieve the goals, or consider whether that mix can be financed. Although it provides some discussion on the sources and the improvements necessary in both grant financing (GN-2653, paras. 4.17-4.22) and loan financing (paras. 4.23-4.25), is does not assess the gap between availability and needs. In short, neither the Strategy nor the Action Plan provides a clear sense of whether the goals proposed are feasible, given the available means.

[29] "The GCI-9 renewed and strengthened the Bank's integration mandate to upscale the Bank's interventions, and calls for three major changes in focus: (i) broaden the scope of integration interventions, supplementing the support to regional integration with actions that facilitate integration into the global economy; (ii) mainstream integration into the lending activity of the Bank; and (iii) achieve greater coordination among Bank's sector strategies of all units that hold the potential to contribute to integration outcomes" (par. 5.2).

[30] These changes in focus broadly match the strategies' stated objectives: (i) promote integration knowledge, (ii) promote regional integration initiatives, (iii) increase lending, and (iv) mainstream integration into Bank operations (para. 6.2). Their relationship with the mandate from Governors is less clear (see para. 3.11).

3.20 Although the Strategy mentions past partnerships (mostly in the context of outreach, para. 5.9), it misses the opportunity to clearly delineate the future role of partnerships, which are crucial to the integration program. One of the Bank's greatest comparative advantages is its leading role in generating and disseminating knowledge and policy advice in the Region. Given the dwindling resources available for regional technical cooperation and the lack of a regional lending instrument, strategic partnerships that would allow the Bank to leverage its scarce resources could prove invaluable.

3.21 The Strategy and the Action Plan have a very limited analysis of intra-Bank coordination. As for coordination, the Action Plan stresses the existing coordination "pilot" project between INE and INT and calls for the expansion of these efforts. What exactly the pilot effort involved, why it should be replicated, or who would lead these efforts are questions that remain mostly unanswered. Furthermore, although the private sector represents an important part of the lending portfolio, it remains unclear how the Bank's private sector department would coordinate with the sector departments. In sum, although the need to overcome institutional disincentives is recognized, neither the Strategy nor the Action Plan provides actionable—and therefore verifiable—recommendations. This is all the more worrisome, since the Strategy was developed and presented to the Board by INT, which manages only a small part (5%) of the lending portfolio the Strategy covers.

3.22 More importantly, the Strategy fails to address the built-in disincentives for countries to engage in regional projects. The evidence from other multilaterals, and the Bank's own limited experience, indicate that most countries engage in regional projects only if they have access to concessional funding (see RE-415, RE-338, and RE-350). Management has repeatedly acknowledged this point, both in the past strategy (GN-2245-1, paras. 3.7 and 5.5) and in a draft of this one (GN-2565, para. 6.12).[31] Furthermore, during the preliminary discussions about IDB-9, the Governors of the Bank expressed interest in "the development of specific instruments for regional projects and programs."[32] Following that discussion, as part of the background paper for the Integration Strategy, INT elaborated on the options, recommending that the Board "consider innovative mechanisms to expand lending capacity to regional programs, through…allocating grant resources to establish a blending mechanism that provides incentives for the design and implementation of regional programs and coordinated national sovereign investment operations featuring cross-border externalities."[33] During the discussion of that background document, some Directors suggested that a new

31 For instance, the Strategy argued that "there is no funding available with real incentives for regional infrastructure initiatives that can exploit such externalities and even out financial and technical capacity disparities between the participating countries" (para. 3.7).

32 Summary of the Ninety-eighth Meeting of the Board of Governors, Madrid, Spain, 2009 (CA-509).

33 See GN-2565, para. 6.12. A similar statement was repeated in the strategy profile (GN-2565-2, para. 5.11). All mention of it disappeared in the final version, GN-2565-4.

instrument "would not be needed for most integration projects." Management "agreed that the Bank's current mix of instruments could be adapted for effective use for most integration projects."[34] Accordingly, the Strategy proposes a "smart mix" of instruments as an alternative to creating a new instrument: "The Bank will support integration with a balanced combination of policy-based lending, regional and national investment operations, NSG operations, non-reimbursable technical cooperation and knowledge and capacity-building products" (para. 6.11).

3.23 The Strategy provides little guidance as to how the "smart mix" of instruments will contribute to addressing the challenges of regional integration in LAC. After defining the "smart mix" of instruments, the document goes on to discuss the different financial and nonfinancial instruments. Regarding the financial instruments (grants, loans, and guarantees), the Strategy does not discuss the balance between them; for instance, it makes no attempt to clarify when one instrument would be used over the others. Among financial instruments, INT has mostly used investment loans and the sector facility for trade; since the Strategy seems to suggest the importance of using other lending instruments (e.g., policy-based loans), it would be useful to have a discussion of the conditions under which this is desirable and possible. Also, the action plan identifies only one instrument—grants—to compensate for higher transaction and coordination costs. Given the recent years' drastic reductions in the amount of funds for technical cooperation, the possible effectiveness of this approach remains unclear. The Strategy misses the opportunity to discuss which instrument is relevant for achieving what role, and what elements would be taken into account to define the "smart mix." In short, the "smart mix," although a useful device for organizing the presentation of the individual Bank instruments, does not provide any strategic guidance to action. Nor is such guidance to be found in the Action Plan.

3.24 The lack of internal incentives to work in regional integration projects is also acknowledged in the strategy but few solutions are offered. The Strategy makes calls the Bank to "redouble its efforts to critically review the existing resources and […] align them to better implement the strategy, considering the need to provide incentives for the design and implementation of integration projects."[35] The Action Plan further directs responsible units to "provide incentives to staff to develop integration operations, which command high costs due to countries' coordination failures," requesting that these operations be "adequately resourced to undertake their role outlined in this Action Plan and to provide incentives to staff to develop integration operations" (para. 5.3). Neither document offers any further guidance.[36]

[34] Minutes of the Policy and Evaluation Committee Meeting (PEA/10/21). The document under discussion was the strategy profile, GN-2565-2.

[35] Para. 6.18, GN-2565-4.

[36] There is one action regarding incentives in the Action Plan. This reads "Assign administrative transactional budget."

3.25 Moreover, the proposal for a "smart mix" of instruments fails to incorporate the lessons learned from the Bank's previous strategy (GN-2245-1), which emphasized using the "toolkit of financial and non-financial" instruments, urging the Bank to "add regional integration and trade support programs to country loan pipelines" (para. 5.3). It further stressed the importance of using all the instruments in the Bank's integration toolkit, and not just regional technical cooperations (para. 3.27), and it detailed the use of the available instruments (see Annex H for details). In view of the similarities between the "smart mix" of instruments and the "toolkit," the new Integration Strategy would have benefitted from an explicit stocktaking of the lessons learned after six years of implementation of the "toolkit."

3.26 The discussion of programming could also have benefitted from a deeper consideration of the Bank's previous experience. Regional programming was one of the main tasks carried out by INT between 1994 and 2006, when Regional Programming Papers were discontinued. The Strategy and Action Plan insist on the importance of programming to create demand for Bank lending—particularly regional projects. Although the Action Plan suggests developing "Integration Strategy Papers" (para. 1.9), a stocktaking of the previous experience with regional programming is missing. The Strategy should have explored the questions of why regional programming was discontinued, why the present conditions justify resuming this type of exercise, and how the new Integration Strategy Papers would differ from the now-defunct Regional Programming Papers.

3.27 Although the Action Plan contains an annex with specific "actions," responsible units, and a timeline for completion, the vast majority of the actions are too general. Annex I of the Action Plan contains a list of 27 actions and a list of "leading units" to carry out the task. Most of these actions are either very general statements (e.g., dissemination of research through networks, promote strategic partners to support integration, support the Region's south-south cooperation initiatives) or broad summaries of actions the Bank carries out anyway (e.g., evaluation of transnational programs by OVE, research for the biannual flagship report, monitor progress toward the lending target). However, a few more specific actions are defined (e.g., define classification criteria for integration loans, develop a template for the development of policy-based loans for integration). Furthermore, the rationale for some of the actions listed in the annex is not clear from the document; for instance, there are three actions regarding monitoring, which is not mentioned in the Strategy (GN-2565-4), and there is a minimal and unrelated mention of monitoring in the Action Plan (paras. 1.16-1.17).

3.28 Finally, there is a mismatch between the objectives and the lending targets defined by Management and endorsed by Governors. The Governors argued for an increasing engagement, essentially in trade issues and regional programs (Table III-2, AB-2764). However, the targets defined by Management and endorsed by the Governors (Annex 1, AB-2764) explicitly mention—and

crucially depend on—the approval of national infrastructure projects that are within a regional initiative (IIRSA/PPP-PM).

D. Verification mechanisms and risks

1. Definition and baseline

3.29 OVE computed the trade and integration portfolio, including all the operations that the Bank seems to have considered regional (see para. 2.2 above): essentially, international trade operations, private sector regional operations, and infrastructure integration operations (IIRSA and PPP/PM). Even using this broad definition, the Bank has rarely devoted more than 5% of yearly approvals to regional integration projects.[37] Indeed, in over 50 years of Bank history, trade and integration projects have exceeded 10% of the lending portfolio in only two years—in 2006 and 2007, when the Norte Grande infrastructure loans to Argentina (AR-L1014 and AR-L1021 for national road infrastructure and a national electricity transmission line) were approved for a combined US$1.8 billion. Even if these loans are considered as having substantial cross-border externalities—something that is neither obvious nor discussed in the loan proposals (see Box 2)—the "baseline" obtained from taking these years into consideration is an aberration that highly distorts the institution's historical performance in lending for trade and integration (see Figure 3). Historically, IDB has devoted not more than 5% of its approvals to trade and regional integration—about half what the IDB-9 Agreement indicated as the baseline.

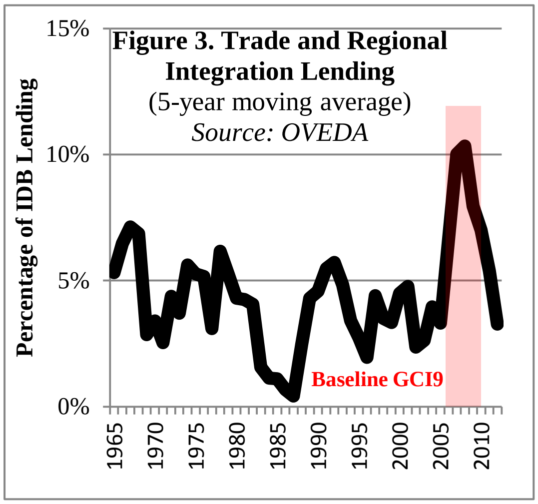

Figure 3. Trade and Regional Integration Lending
(5-year moving average)
Source: OVEDA

3.30 The new Integration Strategy again provides a broad definition to classify projects that contribute to regional integration. More specifically, the Strategy proposes four not mutually exclusive criteria to classify regional projects: (i) cross-country focus, defined as "contributing directly or indirectly to a greater regional or global insertion" (para. 6.10); (ii) regional additionality, defined as generating "value added through the incorporation of objectives of internationalization"; (iii) national subsidiarity, defined as "projects that contribute to the alignment of domestic policy reforms and of national/sub-national investments with cross-border objectives"; and (iv) compensation for coordination failures—that is, projects that address cross-border externalities. The meaning of the third criterion remains

37 Since the proportion of trade and integration projects is very volatile, we have used a five-year moving average.

difficult to interpret. Except for the fourth one, all of these criteria are defined in broad terms and difficult to translate into a practical, implementable definition. The Action Plan does not provide more guidance on the classification and states that SPD will develop guidelines and a monitoring mechanism (para. 4.24).

3.31 The classification of regional projects featured as one of the main topics in the Board's discussion of the Integration Strategy. Several Directors indicated that "integration projects should be defined broadly enough to meet the ambitious [IDB-9] target for integration lending—in particular by including projects which, though confined to a single country, are nonetheless conducive to integration with others (e.g., the national segment of a regional highway project)."[38] Some Directors cautioned Management "against 'creative accounting' to force the classification of operations as integration projects" (PED/11/4). Directors provided no further guidance at that stage about the dividing line between national projects with and those without significant regional externalities.

2. Guidelines for classification of regional projects

3.32 Management guidelines (GN-2650) do not exclude any project from contributing to the regional lending target. Furthermore, they pre-identify about one-third of the subsectors of the Bank as likely to do so: SPD mapped the 150 subsectors of the Bank on whether they fulfill none, one, or many of the lending targets; and for regional integration, 17 subsectors were identified as "automatic" and 33 as "conditional."[39] The "subsectors that are not identified as either automatic or conditional are considered less likely to be able to demonstrate results related to the lending category, but are in no way excluded from the possibility of presenting evidence for classification." So, no project is in principle excluded from the regional classification, and up to 33% of Bank subsectors are pre-identified as being regional.

3.33 If the SPD guidelines are used, the lending target for regional integration is achieved at the baseline under most plausible assumptions. OVE used Management's guidelines to estimate the number of regional projects. Figure 4 shows three possible scenarios, depending on the treatment conditional projects receive: (i) the "maximalist" scenario computes the total of all automatic (A), conditional (C), and infrastructure initiatives (I); (ii) the "intermediate" scenario

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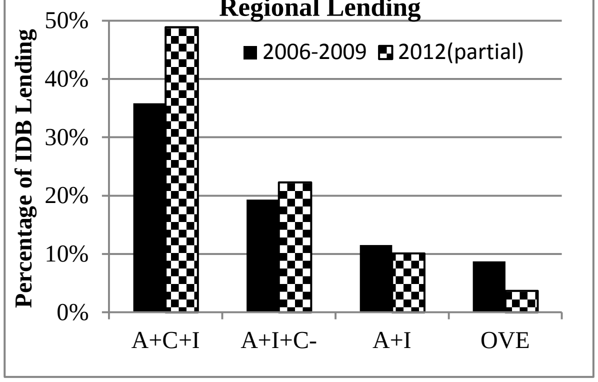
38 PEA/10/21.

39 The automatic sectors are (1) Agricultural Health and Food Safety, (2) Energy Integration, (3) Enabling Environment for Sustainable Integration, (4) Regional and Cross-Border Cooperation, (5)Information and Communication Technology, (6) Telecommunications Infrastructure, (7) Regional R&D and Regulatory Harmonization, (8) Public Policy in Telecommunications, (9) Export and Investment Promotion, (10) Trade Adjustment Assistance, (11) Trade Facilitation, Trade Logistics and Customs, (12) Trade and Investment Agreements and Regulations, (13) Airport Infrastructure, (14) Border Crossings and Infrastructure, Equipment for Border Crossings, (15) Transport Networks Connectivity, (16) Logistic Planning, Multimodal Transport and Logistic Platforms, and (17) Port Infrastructure.

labels as regional all the projects that are likely to be considered regional according to a desk review carried out by OVE; and (iii) the “minimalist” scenario assumes that no conditional project will actually be tagged as regional. The fourth column is OVE’s benchmark calculation of trade and integration projects as described in paragraph 2.2. It turns out that in either the maximalist or the intermediate approach, the “baseline” is above 20% of Bank lending—well above the baseline of IDB-9 (10%) or even the target (15%). When all the conditional subsectors are excluded, the picture more closely resembles OVE’s calculation of trade and integration projects. In sum, the assumptions made about the “conditional” sectors will be the crucial element for attaining the target.

3.34 The guidelines do not indicate what criteria should be evaluated for a project in a conditional sector to be considered a regional integration project. The only guidance to be found in the document is a reference to whether the Proposal for Operations Development “empirically justifies it,” but what the basis of the “empirical justification” should be remains undefined. The guidelines place no restriction on what can be classified as contributing to the regional lending target, in terms of either a sector-subsector mapping or other criteria. This is particularly worrisome because—as shown above—“conditional” sectors are the key to fulfilling the lending target. In sum, the baseline for regional integration is not in line with the Bank’s historical approvals for trade and integration. Furthermore, the classification of regional projects proposed by SPD—although it contributes to making the IDB-9 target attainable—is largely unable to reflect potential changes in the strategic behavior of the institution as intended by the Governors’ mandate (para. 3.1, AB-2764).

Figure 4.: Alternative Scenarios of Regional Lending



Source: OVEDA, using SPD Guidelines. A=automatic subsectors, C=conditional subsectors, C- = projects in conditional subsectors likely to be labeled as regional, I=Infrastructure projects (IIRSA/PM), OVE=trade and integration portfolio according to OVE (see text).

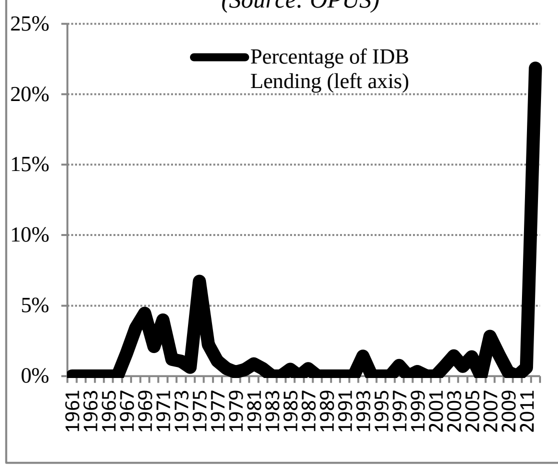
3. Measuring actual progress toward the IDB-9 target

3.35 Turning to the actual measurement of progress in the attainment of the integration lending target, OVE reviewed different sources of information. Since not all of them appear to be fully consistent with each other, we will discuss several alternative measures. First, we will focus on the projects identified as fulfilling the target of regional integration in the Bank's operational systems (OPUS), particularly looking at the approvals for 2011, 2012, and the existing pipeline. Then we will turn to the Bank's classifications of regional projects according to the DEM. Finally, we will compare the two sources with different Bank documents reflecting the progress toward the achievement of the lending target (e.g., DEO; Operational Program Reports)

3.36 According to the Bank systems (OPUS), there has been a recent sharp increase in the projects that contribute to the regional integration lending target. As a proportion of total approvals, regional integration projects went from representing less than 1% of approvals in 2009, 2010, or 2011 to 22% in 2012. Note, however, that using OPUS as a source, the baseline for the regional integration lending target (2006-2009) would yield approximately 1%, significantly below Management's own baseline (10%). Also, according to the DEO, regional integration projects represented 12% of approvals in 2011, a figure substantially above that recorded in OPUS.

3.37 Looking at recent approvals, according to OPUS (Figure 5) there were approvals for only US$56 million (about 0.6%) in 2011, mostly under the trade facilitation program. Only one SG project—an agrifood and animal health project—was considered regional in 2011. In contrast, according to the SG-DEM classification, 25 SG projects for about US$2.5 billion were considered to contribute to the regional integration target.[40] Of these projects, 67% corresponded to transport projects, with agriculture and energy

Figure 5. Regional Integration Projects
(Source: OPUS)



[40] For this exercise we examined the DEM for 2011 (IDBDOCS#36650632) and took into consideration all the projects that were marked as fulfilling one or more of the regional integration dimensions (infrastructure, regional initiatives, institutional strengthening, regional public good and capacity development). Note that the figure of US$2.5 billion is even difficult to reconcile with Management's own regional integration figure for 2011 (12%). Given that Bank approvals in 2011 were about US$10.4 billion (see Annual Report, 2011), the 25 regional integration projects according to the DEM would sum to about 25% of Bank approvals, well above the 12% proposed by Management in the DEO (GN-2607-2).

adding an additional 8% each. Only one trade project (representing 1.9% of the portfolio) was included. In aggregate, about half of the total amounts approved for integration in 2011 according to the DEM is accounted for by a single project, the Rodoanel project (see Box 2).

3.38 For 2012, the regional integration program (including the 2012 pipeline) was estimated at about US$4.1 billion, according to OPUS. Of the 38 projects, 8 account for nearly 75% of the total amounts approved for the regional integration target, none of them bearing any discernible connection to regional integration: a few national electricity generation and transmission projects (UR-L1070, PR-L1058, CR-L1049), a project for wastewater treatment (TT-L1026), and even a fiscal consolidation policy-based loan (BR-L1337). Also, both of the road projects connect the main cities in the Dominican Republic and Bolivia respectively, suggesting that the majority benefits are likely to be national. In any case, the regional contribution is not argued explicitly in any of the projects. More generally, OVE compared the SG regional integration projects as classified by OPUS and the DEM in 2012. Of 35 unique projects that are classified as regional, 15 are present in both databases.[41] The other 20 are present in only one database, 11 in OPUS and 9 in the DEM. Regarding the eight large operations discussed above, only one (BR-L1337) is labeled as contributing to the regional integration target in its DEM.[42] That is, the types of projects included in OPUS and the DEM classifications are very different.

3.39 Finally, there are projects in the pipeline for US$2.3 billion in 2013 and US$0.4 billion in 2014, concentrated mostly in infrastructure (52%), institutions for development (31%), private sector operations (15%), and the integration sector (1.4%).[43] Further examination of the pipeline reveals that about half (16 projects, 50% of the amounts) do not have any relationship with regional integration or the Integration Strategy: two national tourism programs, two national citizen security interventions, and a few policy-based loans for competitiveness or fiscal consolidation. The other 7 projects (21% of the amounts) have *a priori* a clear connection with regional integration; they are mostly border crossing loans. Finally, in the remaining cases the available documentation was not enough to make a judgment, or the connection was in principle weak although not entirely implausible (e.g., a project that finances scholarships abroad).

3.40 An additional challenge is the inconsistencies between the treatment the same database gives to similar operations. For instance, operations that are very similar

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41 This is comparing the SG projects labeled as regional integration projects according to OPUS (26 projects) and the projects labeled as regional integration according to the DEM (24 projects). In both databases there were 35 unique projects, meaning that 15 projects were present in both databases. This yields a consistency rate of 42% (15/35).

42 Of the eight projects, only five had a DEM. Of the missing three, two had not yet been approved and the third one is an NSG project.

43 The pipeline was calculated as of November 2012.

in terms of their objectives (e.g., two PROCONFIS operations, two phases of a conditional credit line) receive different treatment.[44]

3.41 The tendency of a large number of projects not related to trade and infrastructure integration to be included in the lending target is also noteworthy. In particular, the inclusion of a large number of PBLs for fiscal consolidation and citizen security, or tourism projects seems hard to justify in the light of the specific guidelines provided by Governors in the IDB-9 Agreement (AB-2764, Annex, Section III.D.) and Management's own Integration Strategy.

3.42 Finally, in discussing progress toward the achievement of the lending target, Management documents—even those produced almost simultaneously—have had very limited consistency. For instance, the Operational Program Report (GN-2661-4) from May 2012 anticipated approvals for the regional integration target on the order of 2%. However, in the preview of the operational program for 2013 (CP-3463), which was discussed just two months later (July), anticipated approvals for 2012 had increased to 17%.

3.43 Summarizing, there seems to be a generalized confusion and lack of transparency regarding the classification of regional integration projects at the Bank. The all-encompassing definition provided by the Strategy and the classification guidelines developed later are not useful to distinguish between projects that do and those that do not contribute to regional integration—they effectively allow every project to be a regional integration project. In addition, the classification of regional integration projects as provided by different systems (DEM, OPUS) is often contradictory and would yield very different results. To complicate matters further, Management has reported figures for the regional integration target that are quite inconsistent, even between documents that have been produced almost simultaneously. In view of these challenges, increasing the transparency of both the definition and the classification of projects that contribute to regional integration should be a top priority.

4. Indicators

3.44 The indicators of the Strategy come directly from the IDB-9 Agreement. There are three development outcome indicators: trade openness, intraregional trade, and FDI inflows. The IDB-9 Report proposes to achieve these goals by means of four outputs that are mapped to each outcome (para. 4.13, AB-2764, Annex 1). There are three main difficulties with this: (i) the outcome indicators are not

44 For instance, in AR-L1133 the DEM mentions the contribution to "lending for poverty reduction" but not for regional integration. In OPUS, the project is seen as contributing to regional integration. Conversely, the fiscal consolidation program for Rio Grande do Sul in Brazil (BR-L1361) indicates in the DEM that "the intervention is aligned with the lending program to support regional cooperation and integration"; the OPUS classification, instead, records the project as contributing to "poverty reduction." Some projects approved under an "umbrella" (conditional credit lines, fiscal consolidation programs) are sometimes considered regional and others not.

attributable to Bank action; (ii) the mapping of the output indicators to outcome indicators presents some challenges; and (iii) the outcomes and output indicators are generally lacking some of the basic properties of good indicators. We will cover these points in turn.

3.45 **The proposed outcomes are not attributable**. The three outcome indicators are aggregate, regional indicators that are mostly driven by other factors, such as real exchange rates and the business cycle in trade partners. Even if the Bank's actions were effective, many other things are happening that could be moving the indicator in different directions. For instance, the Region has become "more open" in the last decade, mostly because of the commodity price boom and independently of the approximately US$300 million in trade projects the Bank has approved since 2000. In sum, although the regional development outcomes may be a useful tool to monitor the progress of trade integration in the Region, they are of no use in monitoring the Bank's contribution as intended by Governors (para. 4.3-4.4, Annex, AB-2764).

3.46 **Computation and verification of outcome and output indicators.** The Strategy discusses neither the sources for verification of outcome and output indicators nor the criteria used to calculate the baselines. Also, the actual computation of some indicators presents some challenges. For instance, in the case of trade openness, the reported baseline is 84.9% of GDP. Although the document does not specify how the figure was calculated, it is consistent with averaging the national trade-to-GDP figures for the 26 borrowing member countries (84 percent of GDP) rather than with computing aggregate trade in the Region relative to aggregate output (45% of GDP).[45] This approach is misleading on various accounts: first, trade openness varies dramatically with the size of the economies, with large economies usually being less open. Therefore, averaging trade-to-GDP grossly overestimates the "regional" trade openness.[46] It also introduces artificial biases, implicitly treating a 1% increase in Brazilian trade openness as equivalent to a 1% increase in Belizean openness; since Brazil's GDP was about 800 times larger than Belize's in 2005, the estimate would be very poor in capturing the "average" increase in trade openness in the Region. The FDI indicator has a similar problem: average FDI in the Region has been 2% in recent years, rather than the 4% that would result from averaging national figures and that is presented in the IDB-9 results framework.

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45 Using the World Bank's World Development Indicators. For the 26 member countries, the average of their trade-to-GDP ratios is 83.6% for 2005, the last year in which the figure was available for all countries. Instead, if we average the aggregate trade of the Region relative to the aggregate GDP, the figure is reduced to 47.3%. The reason for this is that the last figure is implicitly weighted by the size of the economies. Given that there a strong negative correlation (0.7) between size of an economy and the level of openness, averaging country ratios is highly misleading.

46 For instance, the average trade-to-GDP was reduced from 82 to 71 between 2005-2008 and 2009-2011, because of the impact of the crisis on the small open economies of Central America and the Caribbean. However, the correct measure of trade was reduced only from 50% to 46%—probably a more realistic reflection of the Region's reduction in trade.

3.47 **Quality of output indicators.** The output indicators are in general inadequate, have a weak connection with outcomes, and are incomplete (e.g., only three have baselines). It is not clear where the indicators came from or how they can be verified. As stated above, it is almost impossible to assess whether these indicators are "realistic," as neither the Strategy nor the Action Plan tries to estimate what resources are currently used or are needed to move forward."[47]

5. Strategy supervision

3.48 The Strategy document does not discuss the supervision of its implementation. The Action Plan contains two brief mentions of monitoring: (i) a proposal to incorporate OVE's evaluation of transnational programs (para. 1.16), and (ii) a general statement about Management monitoring outputs and the lending target (para. 1.17).

6. Risks

3.49 The strategy fails to identify true risks. At the core of any definition of risk is the idea that there are events whose occurrence is uncertain, which may affect the degree to which the organization's objectives are achieved.[48] Seen in this light, the two "risks" mentioned by the Integration Strategy are not risks since they are not uncertain. The first risk is that there might be "an insufficient demand of client countries." In discussing this risk, the Strategy explains that (i) projects with cross-border externalities are more difficult and costlier than others, (ii) countries tend to give national projects greater priority, and (iii) transnational projects tend to take longer to mature. OVE agrees with these three statements; however, devising adequate instruments to tackle the difficulties of working regionally should be the central tenet of the Integration Strategy and not a risk posed to it. Furthermore, there is little uncertainty about the lack of demand for regional projects. Such lack of demand would be uncertain if it were explained by

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47 For example, the indicator "regional and sub-regional integration agreements and cooperation initiatives supported" is not specific as it does not give a clear sense of what "supporting" means. Also, it is not clear that "supporting" subregional cooperation schemes increases intra-regional trade. Indeed, LAC's intraregional trade is among the lowest in the world, and the number of subregional agreements in LAC is among the highest. Regarding the "number of cross-border and transnational projects supported," the problem is that the Bank lacks a definition of "cross-border" and "transnational" project. In OVE's view there have been only two transnational projects in the last 12 years, both approved before 2004, this is impossible to reconcile with the baseline. "Number of international trade transactions financed" has no effect on FDI and, given the limited number of transactions, probably not a discernible effect on trade openness. "Mobilization volume by NSG financed project/companies" is not specific enough, particularly regarding the meaning and calculation of "mobilization volume."

48 The ISO31000 standards for risk management define risk as "the effect of uncertainty on the objectives." The document begins with a broader description of risk: "Organizations of any kind face internal and external factors and influences that make it uncertain whether, when and the extent to which they will achieve or exceed their objectives. The effect this uncertainty has on the organization's objectives is 'risk.'"

circumstantial events such as the declining momentum of regional integration schemes or a widespread financial crisis that triggers protectionism. Instead, the three arguments presented in the Strategy point to structural problems that have been repeatedly identified by the literature, the evaluation offices of other MDBs, and OVE. Lack of demand for regional integration projects, given the present set of rules and incentives, is almost certain.

3.50 The second risk mentioned by the Strategy is that "the timeframe to assess the effectiveness of the strategy may be too short, even in the presence of progress." Again, it is difficult to assess what is the "uncertain" event underlying this claim, and it is not clear what the realization of the "risk" is or how it would affect the objectives of the Strategy. But even more, this statement is impossible to prove wrong; that is, regardless of the time in which the observer tries to prove the statement false, it can always be argued that it is "too soon." To sum up, it is not clear that the second risk is actually uncertain and, furthermore, it is not even observable.

3.51 The Strategy is silent about the likelihood that these "risks" will materialize, or the impact on the attainment of the objectives of the Strategy if they were to materialize. However, it "proposes to mitigate these risks with proactive programming and a more efficient mix of available instruments" (para. 6.20). It is unclear how proactive programming would address the lack of demand in the absence of financial elements to "sweeten the pot" for borrowers. Another proposed mitigation measure is to provide a "more efficient mix of available instruments." In general it is difficult to understand from this statement what the specific mitigation measures would be. Also, if a more efficient mix of existing instruments were actually possible, it is surprising that the Bank would not apply it in the first place so as to avoid the materialization of the risk. Interestingly, the paragraph on risk mitigation finishes with the following caveat: "However, the lack of political will among potentially integrating countries may render the Bank's incentives ineffective altogether" (para. 6.20). Although it is not identified as such in the strategy, the "lack of political will" constitutes a risk—as well as an opportunity, as argued above—for the Integration Strategy. It should have been explored further. Also important, the strategy would have benefited from a more thorough analysis of the risks posed by the transition of IIRSA to the orbit of the Union of South American Nations and the effective end of the Bank's role as IIRSA technical secretariat.

3.52 The purpose of identifying risks is to devise adequate strategies to manage them. To do so, it is important to understand what the organization can affect and what is purely exogenous. In addition, it is crucial to characterize the occurrence of the events and the potential impact.[49] Seen in this light, the risks identified by the

[49] There is an extensive management literature on the role of risk and how to manage it in an organizational context. See, for instance, Robinson, David (2007), "A Primer on the Management of Risk and Uncertainty," *Rotman Magazine*, Spring.

Strategy are mostly not uncertain—i.e., they are not risks—and there are no actions that the Bank can take to mitigate them. In sum, the risk analysis of the Integration Strategy is ineffective.

7. Use of the strategy

3.53 OVE's staff survey (see background paper and Annex I) indicates that the Integration Strategy is not much used by Bank staff, except for INT, where staff claim to know the document (92%) although only about half report having used it for preparing loans. By contrast, 64% of the respondents at VPC claim to either not know (28%) or to have just heard (36%) about it, and about 80% of the respondents have rarely or never used the Strategy in the last year.

3.54 Management has, however, informed OVE that they find the Strategy beneficial and that several tasks have been carried out since its approval. In their view, the Strategy has guided Bank actions. In particular, Management maintains that coordination between INT and INE has increased, that the institutional organization has become more aligned as INTAL was moved from VPC to VPS, and that the technical cooperation, capacity building, and research programs have all been strengthened since the approval of the Strategy. Management indicated to OVE that they have piloted a "double-booking" exercise in the hope of increasing incentives. In addition, INT's leverage within the organization seems to have increased, particularly with the creation of the lending target. Although OVE recognizes Management's efforts to increase the effectiveness of the Bank's regional integration program, many of these activities predate the strategy or are not possible to verify. Thus, while OVE recognizes management efforts, it is not obvious that they will increase the effectiveness of the regional integration program of the Bank.

IV. Conclusions and Suggestions Going Forward

"Would you tell me, please, which way I ought to go from here?"
"That depends a good deal on where you want to get to," said the Cat.
"I don't much care where—" said Alice.
"Then it doesn't matter which way you go," said the Cat.
"—so long as I get somewhere," Alice added as an explanation.
"Oh, you're sure to do that," said the Cat, "if you only walk long enough."
Lewis Carroll, *Alice's Adventures in Wonderland*

4.1 Regional integration and cooperation has been a constant goal of the Bank since its inception. Historically, the Bank has been inextricably intertwined with the LAC integration process, to which it owes its creation and to which it has significantly contributed, particularly early in its history. After a period of lethargy in the 1980s, the Region found a new integration paradigm in the 1990s under the "new regionalism." The Bank swiftly responded with the creation of INT, the revival of INTAL, and the approval of an Integration Strategy. Turning this integrationist spirit into a lending program has proved to be a persistent challenge for the institution: historically, no more than 5% of the Bank's loans have been devoted to regional integration and cooperation.

4.2 IDB—like other development institutions (for example, the World Bank and the African and Asian Development Banks)—has long been aware of the challenges related to funding regional integration projects. Even when loans are executed at national level, effectively designing and coordinating ambitious regional integration projects entails higher costs, longer preparation and execution times, and higher vulnerability to political shocks—all strong disincentives for both the Bank and the countries. OVE has consistently maintained that the lack of adequate instruments to deal with these projects is a major constraint to the relevance of the Bank's regional integration program (RE-338, RE-350, RE-415). Management has also long noted the built-in challenges of regional integration projects: for instance, on justifying the use of FSO resources to finance a program with CABEI, Management stated that "integration projects require a special incentive, since the countries tend to assign higher priority to the use of their resources for projects of interest and benefit on the national level" (PR-452, 1970). More recently, both the former integration strategy (GN-2245-1) and the first background paper for the new Strategy (GN-2565) have insisted on the need for a financial instrument to overcome the disincentives countries face. Similarly, the Board of Governors acknowledged that projects with cross-border externalities were "special operations" and granted eligibility for FSO resources (AB-303-3, May 1972). This mandate—although difficult to implement as FSO resources dwindled—is still technically valid.

4.3 The Bank has tried to address the issue of lack of incentives for regional integration projects, with limited results. With declining FSO resources to subsidize lending and technical assistance for regional integration projects, the

Bank has resorted to different instruments to tackle the issue: it created a sector facility for transnational projects in 2003 (GN-2085-10) and twice established small preinvestment windows for regional infrastructure projects (PFLAI in 1966 and FIRII in 2005, GN-2344-3). All these windows faced limited demand because they were not financially attractive for borrowers. FIRII, for example, was initially conceived as a contingent recovery facility; when demand failed to materialize, it was converted to a nonreimbursable window. More recently, the Bank also created some sector and thematic trust funds (Aid for Trade, FIRII+) to support technical assistance. Despite these new funds, the resources available for regional cooperation have dwindled, not least because the Governors' mandate to transfer the FSO-financed RTC program to ordinary capital has not yet been carried out.

4.4 As a consequence, the Bank lending program for trade and integration has been de facto (75%) lending for infrastructure projects that are designed and executed as national infrastructure projects. While national projects—if designed and coordinated within a transnational framework—may display regional benefits, the Bank still has no effective mechanism to evaluate projects' regional contribution. As OVE has noted, the Bank's infrastructure integration projects are designed and executed exactly like national infrastructure projects (RE-338, RE-350). Aside from infrastructure integration, only a very small part (about 5%) of the Bank's lending deals with national trade and integration projects (e.g., border crossings) that contribute to regional integration. Without any preferential treatment to compensate for the higher transaction costs of regional integration projects, the Bank has had only two projects with significant cross-border externalities since 2000. These projects materialized when the Bank managed to secure ad hoc concessional resources from bilateral donors (Spain, Norway, and Germany).

4.5 As part of the IDB-9 Agreement, Management was requested to produce a strategy for regional integration to "define the main priorities…and offer guidance to staff on the design and implementation of programs and projects." The Strategy was submitted in a timely manner, with all the supporting annexes and evidence, and a few months afterwards an Action Plan was approved. The Strategy has benefited from a thorough diagnostic and valuable background papers on the challenges to regional integration—particularly focusing on international trade. Thus OVE finds that the requirement for a regional Integration Strategy is fully implemented. However, effective implementation requires that the Strategy show the capacity to guide the Bank's future behavior.

4.6 The new Integration Strategy (GN-2565-4) identifies operational challenges related to working at a regional level: the high costs for countries, particularly regarding coordination; the asymmetries in the distribution of costs and benefits; and the limited incentives for Bank staff to engage in what are generally nonlending operations. OVE agrees with this diagnostic, as it has in many recent evaluations (RE-338, RE-350, RE-415). Furthermore, OVE agrees with Management's initial drive to develop "new instruments" (i.e., improving the economic conditions) for regional integration. Although the Board of Governors

initially expressed support for the "development of specific instruments for regional projects and programs," in the discussions at the Board of Executive Directors, several chairs noted that a new instrument "would not be needed for most integration projects." As a consequence, the final version of the Integration Strategy misses the opportunity to address the crucial issue of lack of preferential treatment for regional integration operations. Instead, it proposes a "smart mix" of existing financial and nonfinancial instruments (e.g., policy research, capacity building, programming, and financial instruments).

4.7 Although a good tool to understand the available instruments, the "smart mix" as described in the Strategy falls short of providing any strategic guidance as to how these "instruments" will be applied and exactly how they will generate the demand for regional integration operations that has been historically so elusive. Given these challenges, the Strategy could have benefited from an explicit stocktaking of the Bank's previous strategic approach, namely the "toolkit of financial and non-financial instruments" (GN-2245-1). In particular, it would be useful to have an explicit comparison of both approaches, indicating the similarities and differences.

4.8 The document provides limited guidance on the organizational aspects of regional work at the IDB—how the Strategy will be articulated across the Bank, and what role INT will have in ensuring the achievement of the goals when it leads the strategic discussions and INE leads the lending. Although, Management has expressed the view that coordination has improved between INE and INT, the effect of adding a "regional integration" perspective into infrastructure integration projects has yet to be seen. Finally, it is difficult to say whether the goals of the Strategy are adequate, as there is no indication of whether they are in line with the available means. In particular, the Strategy fails to quantify the size of the interventions and to discuss alternative partnerships and resource mobilization, which are crucial in the context of the dwindling resources available for regional technical cooperation. The quality of the indicators identified in the Strategy—inherited from the IDB-9 report—is poor, and the identification of risks is largely ineffective. It is for all these reasons that OVE finds that despite the important efforts of Management, the Strategy and the Action Plan provide very limited guidance for action, and, therefore, are partially ineffective.

4.9 In addition, there seems to be generalized confusion and lack of transparency regarding the definition and classification of regional projects. The definition proposed by the Strategy is too broad and operationally unpractical. The guidelines developed by SPD resulted in a direct mapping of projects from specific sectors and subsectors or specific strategic initiatives into regional integration projects. In practice, this approach has not excluded any Bank project from being regional, and it pre-identified about one-third of the subsectors as being likely to contribute to regional integration. While a sector-specific criterion may be not so distortive in software projects (trade portfolio), it is largely inadequate for the infrastructure integration projects that constitute the bulk of the portfolio covered by the Strategy. The inaccuracy of the present methodology is

illustrated by the fact that if the SPD guidelines for classifying regional projects were applied retroactively, they would indicate that between 20% and 40% percent of Bank lending was regional in 2006-2009—that is, the 2015 target (15%) would already have been easily achieved at the baseline. OVE also found that the calculation of the baseline proposed in the IDB-9 Report (10%) is particularly affected by the timing of two large infrastructure operations in Argentina and does not reflect the Bank's historical engagement in regional integration (less than 5%).

4.10 Moreover, OVE found serious difficulties with the application of the rules for classifying projects that contribute to the regional integration lending target.

- There are pervasive inconsistencies between the classification of regional projects as presented by the different Bank reports and databases (e.g. DEM, DEO, OPUS). And these differences are significant; for instance, according to OPUS, regional integration projects were about 0.6% of Bank lending in 2011; the DEO classifies 12% of that year's Bank lending as regional; and if all the projects with a DEM that indicates alignment with "regional integration" are summed, about US$2.5 billion (roughly 25%) of Bank overall lending in 2011 would be regional. Furthermore, using the OPUS database it is impossible to recreate the baseline of the IDB-9 agreement (10% for 2006-2009).

- Even documents that have been produced almost simultaneously have very different implications in terms of regional integration lending.

- Projects that are very similar in nature (e.g., phases of Conditional Credit Line) receive different treatment regarding their regional integration contribution.

- And finally, projects that bear no discernible connection with the Governors' mandate for regional integration (e.g., citizen security, fiscal consolidation policy-based loans) have been identified as contributing to regional integration.

4.11 In view of all these challenges, OVE is concerned with the potential misrepresentation of the Bank's regional integration work. Not only there is a reputational risk for the IDB but, more importantly, by exaggerating its contribution to regional integration, the Bank misses the opportunity to address the real challenges that have hindered the effectiveness of its regional integration program.

4.12 It is precisely with the recent capital increase—and its renewed commitment to regional integration—that decisions abour the future strategy should be taken. In this context, OVE's first suggestion—directed to Governors—focuses on the different alternatives for this new strategic positioning, providing a choice between continuity and change. The second suggestion—directed to

Management—focuses on the classification of regional projects. Unfortunately, the concerns of some Directors regarding "creative accounting" to meet the lending target were justified.[50] In that sense, OVE calls on Management to provide a clear, transparent, and candid assessment regarding the projects that are counted towards the regional integration target.

4.13 **Suggestion 1: Define the new strategic approach to regional integration based on risk appetite.** At this crossroads, the Governors of the Bank have an opportunity to redefine the role they envision for the institution in terms of regional integration and cooperation. Two options emerge. One—the one proposed by the integration strategy—does not require any major change and proposes a sort of enhanced continuity, where an effort is made to coordinate existing financial and nonfinancial instruments under a "smart mix" of instruments. Without more details, it is not very clear how the present Strategy will succeed where the previous one failed. Also, without specific economic incentives to countries, it is unlikely that a greater demand for regional integration projects would emerge (particularly, those that Governors stressed in Table III-2 of the GCI-9 document), and the demand for trade projects is quite limited. In consequence, the resulting equilibrium is likely to be similar to the one we now have: most of the lending would be devoted to infrastructure integration projects with no proved (and unlikely) regional contribution. A minimum share of the loans would go to national trade sector loans (customs, export promotion). This approach seems to be very conservative and entails very low risk. In particular, it does not require an increase in resources or granting any preferential treatment for regional integration projects. It should be noted that the payoff in terms of its contribution to regional integration is also very low.

4.14 A second approach is to tackle the real problem that has been precluding the development of lending for regional integration—not only in the IDB but also in other MDBs: the lack of preferential conditions to support projects that effectively contribute to regional integration, such as national projects effectively coordinated in a transnational framework, or multicountry projects. If this option is pursued, Governors would have to make the necessary resource allocations, including increasing the attractiveness of regional integration projects through more concessionality, more technical cooperation, and possibly an earmarked envelope from ordinary capital. Once the resources are secured, the Bank would need to develop a clear and transparent methodology to distinguish which projects—in the light of their contribution to regional integration—are likely to need preferential treatment and which would not. Transparency and clarity are essential preconditions, as once the preferential window is open, perverse incentives to disguise nonregional projects as regional projects may arise. Also, Management's incentives to engage in regional integration projects would have to be reconsidered. As for the likely outcome, all the MDBs that have created a regional

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50 See PEA/11/4.

lending program have faced important operational challenges, including higher costs and risks. However, the development impact is potentially high.

4.15 OVE finds that both options are reasonable, and they map the set of possible risks and payoffs. The right choice essentially depends on the risk appetite of Governors and the willingness to boost the Bank's role in regional integration and cooperation.

4.16 **Suggestion 2: Improve measurement of projects contributing to the lending target.** Irrespective of the strategic path the Bank decides to follow, in the future it will be essential to have an accurate measurement of the Bank's contribution to regional projects. The Bank's contribution to regional integration is not increased if projects get relabeled. In that regard, in the future, Management should submit a practical and actionable definition of regional integration projects to the Board of Executive Directors, including (i) precise guidelines on how they intend to apply it to the Bank's future lending, and (ii) a tentative classification of the pipeline for 2013-2014 using the proposed definition. It would be then up to the Board of Executive Directors to decide whether the Governors' intent as set forth in Cancun is fully captured by the proposed definition. Once the definition is agreed on, it should be (i) applied on a project-by-project basis (i.e., no automatic categories); (ii) briefly justified in the project document; (iii) fully linked to (and consistent with) the Bank's databases (particularly OPUS and DEM); and (iv) accessible through the Internet, where progress toward the lending target—including the projects that are contributing to it—could be tracked by the Board of Executive Directors, Management, and other stakeholders in the Region.

4.17 It is likely that once an earnest assessment of the Bank's regional integration portfolio is made, the Bank's alleged contribution will be significantly reduced. If that were the case, it might be necessary for Governors to rethink the appropriateness of the objectives and the lending target in view of the available instruments, the resources the Bank is willing to commit to regional integration, and the political will of the Region to move forward with this priority.

LIST OF PERSONS INTERVIEWED (INCLUDING OVE'S TRANSNATIONAL EVALUATION)

During the Evaluation of Transnational Programs (RE-415) and the present evaluation, OVE visited Argentina, Barbados, Brazil, Colombia, Costa Rica, El Salvador, Guyana, Panama and Uruguay, where it met with Bank operational staff (Representatives, Chief of Operations, fiduciary specialists) and specialists in charge of executing the trade and integration portfolio. OVE also interviewed Bank staff in headquarters—including senior management—regarding other operational aspects of regional projects. OVE also carried out interviews with the African Development Bank, the Asian Development Bank, the World Bank, and other regional comparators (CAF, CDB) regarding their approaches to regional integration projects. Representatives of regional organizations such as Mercosur, ALADI, SICA (including SISCA and COMISCA), and CARICOM (including the CSME unit in Barbados) were interviewed. Finally, OVE interviewed about 10 high-ranking officials in LAC Ministries of Transportation and Public Works regarding the challenges of infrastructure integration in the region. Public officials were also interviewed regarding international trade issues in LAC. In total, about 300 interviews were carried out for both evaluations. Some of the most important interviews are listed below.

Name	Affiliation
Aaron Zazueta	Global Environmental Facility Evaluation Office
Albert-Eneas Gakusi	Senior Evaluator, Evaluation Office, African Development Bank
Alex Rugamba	Director, Regional Infrastructure and NEPAD, African Development Bank
Alvaro Ons	Ambassador, Director General for Integration and Mercosur
Andrés Suarez	Financial Specialist - Costa Rica, IDB
Anne-Marie Ready	First Secretary, Development, High Commission for Canada, Caribbean
Antoni Estevadeordal	Manager, Trade and Integration Sector, IDB
Arjun Goswami	Director, Regional Cooperation and Operations Coordination Division, ADB
Arjun Tharpan	Arjun Thapan, former Director General, Southeast Asia Department, ADB
Ben Petrazzini	Senior Program Specialist, LAC regional office, IDRC, Canada
Carlos Trujillo	Energy Principal Specialist - SIEPAC, IDB
Christina Wedekull	SIDA, former Executive Director for Sweden at the IDB
David Jay Green	Research Fellow, Asian Institute of Management. Former Director, Regional Cooperation Southeast Asia, ADB
Diego Buchara	Attorney Lead Specialist, IDB
Diego Fernandez	Department of Cooperation and Capacity Building, Latin American Integration Association (ALADI)
Diego Morris	Business Climate Reforms, Compete Caribbean, IDB
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Hazel Escrich	Secretary General, Secretariat for Central American Social Integration (SISCA), SICA
Hector Rabade	Fiduciary Lead Specialist, IDB
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Juan Carlos de la Hoz	Chief of Operations Brazil, IDB
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Marcela Ruth Espinoza Nissim	National Directorate of Borders. Ministry of Foreign Affairs. IIRSA Coordinator. Chile
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Ralph Olaye	Manager, Regional Infrastructure and NEPAD, African Development Bank
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Robert D Van den Berg	Director, Global Environmental Facility Evaluation Office
Robert Devlin	Director of the Department of Effective Public Management, OAS & former Deputy Manager of the Integration and Regional Programs Department at the IDB
Roberto Vellutini	Vice-President for Countries, IDB
Rodrigo Parrot	Country Representative, El Salvador (VPC), IDB
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ANNEX A. REGIONAL INTEGRATION IN THE SUCCESSIVE CAPITAL REPLENISHMENTS

IDB Capital Replenishments	Integration focus	Trade & integration priority
Second Replenishment (1967-1969)	Sector priority: economic integration, intra-regional trade.	YES
Third Replenishment (1970-1974)	Sector priority: physical infrastructure (transportation, energy and telecommunications).	YES
Fourth Replenishment (1975-1977)	Sector priority: exports expansion.	YES
Fifth Replenishment (1978-1982)	Sector priority: external sector.	YES
Sixth Replenishment (1983-1988)	Integration was not included as a sector priority.	NO
Seventh Replenishment (1989-1994)	Integration was not included as a sector priority. Increase competitiveness (both in domestic and external sectors). Resource mobilization to the private sector through support of privatization, trade liberalization, and policies oriented toward attracting direct foreign investment.	PARTIALLY (through reform and modernization)
Eighth Replenishment (1994-2009)	Sector priority: modernization and integration. Bank's role as facilitator of private investment to increase competition in freer markets, direct investment, and strategic alliances between local and foreign firms.	YES
Ninth Replenishment (2010-)	Sector priority: competitive regional and global international integration.	YES

Source: Author's analysis of Management's document "A Review of Past Bank Replenishments," January 1999, and the IDB-9 Report (AB-2764).

ANNEX B. CHRONOLOGY OF REGIONAL INTEGRATION: THE BANK AND THE REGION

Years	Regional integration process	Bank actions
1960-1974	1. Foundation of integration schemes in LAC (LAFTA, 1960; CACM, 1960; CARIFTA, 1965; Andean Pact, 1969). In 1973, CARIFTA is superseded by CARICOM. 2. Foundation of Financial Institutions to support the Regional Integration Efforts (IDB, 1959; CABEI, 1960; CAF, 1970, Fonplata, 1974) 3. Presidential Support to Integration: Punta del Este Declaration, 1961 (Alliance for Progress); Punta del Este Declaration, 1967 (transnational infrastructure projects) 4. Difficulties towards the end of the period: Football War (1969) between Honduras and El Salvador. CACM suspended; LAFTA advances sluggishly towards regional integration.	1. Felipe Herrera's "We shall be the Bank of Integration" (1961) 2. Program for Financing Intraregional Capital Exports (1963, AG-8/63, DE-59/63) 3. Creation of INTAL (1965) 4. Felipe Herrera (*et. al*) advice governments how to speed up the integration process (1965). 5. Creation of a Preinvestment Fund for Latin American Integration (See Annex E) (1966) 6. The Bank organizes a round table on "multinational projects" (1968) 7. An inventory of physical integration projects is carried out (1969-1971).
1975-1989	1. Chile abandons CAN (1976) 2. In view of the limited advances progress of LAFTA, ALADI is created under a less ambitious and target-free approach to integration (1980)	1. Some physical infrastructure projects financed. E.g. Yaciretá Dam between Argentina and Paraguay
1990-2005	1. **Regional schemes founded or redesigned**: Mercosur (1991), Free trade area established within CAN (1993), Protocolo de Tegucigalpa, SICA supersedes CACM (1991); Creation of the Caribbean Single Market Economy within CARICOM (1989-2002). 2. **New Infrastructure integration initiatives undertaken (IIRSA, PPP-PM) (2000-2001)** 3. **Free Trade Agreement of the Americas (1994-2004).** First summit of the Americas. Negotiations stall around 2003. The 2005 deadline to implement FTAA is missed. In 2004, ALBA created as an alternative to FTAA.	1. Creation of INT (1995) 2. Regional programming (1994-2005) 3. Reaffirmed the commitment to integration and to strengthen regional programming (GN-2077; institutional strategy) 4. First integration Strategy approved (2003) 5. Fund for Preinvestment in Integration (FIRII) is created (2005) 6. Regional Public Goods Initiative is created (2004) 7. New lending instruments for Trade (sector facility, created in 2000) and transnational projects (created in 2003). 8. IDB becomes the technical secretariat of IIRSA. 9. After almost disappearing in 1992 (CS-2372), INTAL is relaunched. 10. FIRII created to support infrastructure integration (2005).
2006-2012	1. **North-South Second Generation agreements**: In response to the failure of FTAA, there are bilateral and multilateral efforts to conclude FTAs with US and EU (e.g. CAFTA-DR (2006). US-Colombia FTA (2006), US-Peru FTA (2006), EU-CARIFORUM (2008)).	1. Regional programming discontinued after 2007. 2. Multidonor fund (FIRII+) created (2011) 3. RTC program *de facto* eliminated (2011) 4. Annual allocation for RPG program halved from 10 to 5 million (2011) 5. Regional strategy approved (2011)

Years	Regional integration process	Bank actions
	2. **Emergence of new integration schemes**: ALBA (2004); CELAC (2012); Alianza del Pacifico (2012). 3. **Changes in the traditional integration blocks**: e.g. Venezuela withdraws from Comunidad Andina (2006) and joins Mercosur (2012); Dominican Republic becomes an associate member of SICA (2004).	

ANNEX C. MANDATE OF THE INTEGRATION DEPARTMENT SINCE 1994

Year	Landmark	INT mandates and responsibilities
1994 (GA-152-4)	Creation of INT as a NON-LENDING department	1. preparation and monitoring of regional programing 2. analysis and dissemination of information on integration processes 3. training for leaders and administrators in social areas 4. carrying out the Bank's regional technical cooperation program, and developing and maintaining a Latin American socioeconomic database
1999 (GA-183-1)	INT gets a LENDING mandate	5. "analysis, processing, and supervision of loan and technical cooperation projects in the fiscal area"
2001 (GA-183-6)	INT goes back to its 1994 mandate.	Fiscal unit (FIS) of INT dissolved. Mandate reduced. 5. ~~"analysis, processing, and supervision of loan and technical cooperation projects in the fiscal area"~~
2004 (GA-183-18)	End of the 1999 reforms. INT remains a NON-LENDING department.	No further changes for INT.
2006 (GA-232-8)	Realignment document. INT receives a LENDING mandate again.	1. "Advises Management on trade and regional development issues, as well as overall Bank strategies and programs in these areas." 2. "It is […] responsible for policy-relevant research on regional and global economic integration issues." 3. Provides "specialized technical sector support to trade and integration-related operations and activities."

ANNEX D. THE PREINVESTMENT FUNDS FOR LATIN AMERICAN INTEGRATION
THE PREINVESTMENT FUND FOR LATIN AMERICAN INTEGRATION (PFLAI)

Around 1960 the political commitment to integration translated into the creation of the Central American Common Market (CACM), the Latin American Free Trade Association, and the IDB—which was later labeled "the Bank of Integration" by its first President. In 1961, political commitment was boosted when presidents of the Hemisphere established a charter and action plan for US-sponsored "Alliance for Progress."[51] The charter contained a specific section on regional integration. By 1965, the progress of towards Latin American integration was not as fast as originally anticipated. Thus, several Latin American scholars—including the President of the IDB—called for the political leaders of the region to accelerate the integration of the region and submitted a specific proposal.[52] In 1967, the Declaration of the Presidents of the Americas at Punta del Este reaffirmed that regional integration as a top priority for the Latin America, establishing a timeline for it and specific actions to achieve the goal. Presidents stated that they "*will lay the physical foundations for Latin American economic integration through multinational projects*" and committed to "*allocate sufficient resources to the Preinvestment Fund for Latin American Integration of the IDB for conducting studies that will make it possible to identify and prepare multinational projects in all fields that may he of importance in promoting regional integration*." [53]

A year before the Punta del Este Declaration, the Board of Governors of the IDB had created the "Fund for Preinvestment Studies in Aspects of Latin American Integration" in order to finance preinvestment studies for infrastructure integration on reimbursable, nonreimbursable, and contingent recovery basis. The areas where the funds should be allocated are: i) multinational infrastructure works, ii) integrated development of regions in two or more countries, iii) basic industry on a regional scale, iv) other integration projects such as the joint exploitation of natural resources or the establishment of multinational agencies or enterprises. In order to secure the sustainability of the Fund, it was established that the Bank should include the full cost of the preinvestment studies in the loans resulting from it—whenever possible. (AG/7-66, april 1966). The Fund was initially endowed with 15 million dollars from the FSO (DE-92/66, although the FSO part was to be used for the loan part exclusively DE-93/66, GN-558), successively complemented by a 1.5 million from the US's Social Progress Trust Fund for the nonreimbursable modalities. The combined amount (16.5 million) is equivalent to some 117 million dollars in 2012.[54]

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[51] The Charter of Punta del Este: Establishing an Alliance for Progress Within the Framework of Operation Pan America; August 17, 1961; Title III, link

[52] Mayobre, José Antonio, Herrera, Felipe, Sanz de Santamaría, Carlos, and Prebisch, Raúl (1965), *Hacia la integración acelerada de América Latina: Proposiciones a los presidentes latinoamericanos.*" México, DF: Fondo de Cultura Económica.

[53] Punta del Este Declaration, link.

[54] Using the BLS inflation calculator (http://www.bls.gov/data/inflation_calculator.htm). The reference to the US contribution comes from the 1967 proceedings of the Board of Governors, available at eArchives.iadb.org.

In 1968, Governors called the Bank to establish a five-year action plan that would take into consideration the following aspects: i) urgency of infrastructure integration in the region, ii) importance of physical integration of low income countries, and iii) an estimation of the resources needed for preinvestment of the five year plan. (AG/6-68). Governors further organized a round table on the issue of multinational projects in their annual meeting of Bogotá in 1968.

In 1969, Management took stock of the experience of the Fund after 2 years of functioning. By then, the Fund had allocated about one-fifth of the total resources. Of the resources approved or committed (3.3 million), only one loan for 7 percent of the total resources was made to finance a preinvestment study for a hydroelectrical project in the Acaray river (Paraguay). In trying to understand the reasons for the imbalance, management argued that high concessionality resources for preinvestment in the form of nonreimbursable funds were widely available from bilateral and multilateral donors, that the initial studies are not project-related and, consequently, unlikely to generate a loan. Finally, it was argued that the integration schemes of the region were still too young to take full advantage of the facility. In concluding they stressed that "*in the case of multinational projects, simultaneous action by the participating countries is made difficult by the need to coordinate the country's decisions and to reconcile the benefits to be received by each, in addition to resolving the complex legal and institutional problems that arise from time to time*." (GN-558, July 1969).

In 1969, the Governors asked the Bank member countries to contribute to the Fund for Preinvestment in order to "*to strengthen its multilateral nature and make possible the expansion thereby ensuring that all the contributing member countries could share its benefits*" (AG-4/69). In response to this call, 2 million dollars were pledged by 1970 for an equivalent of about one-third of the expenditures of the Fund up until then.[55] About 80 percent of the contributions to the fund for nonreimbursable operations (4.25 million) were financed by the US through the Social Progress Trust Fund (GN-558, Annex III). It was then established that the US contributions to the Preinvestment Fund for 1970-1972 "*could not exceed US$1,500,000 and in any event would be limited to three times the total amount committed and paid by the Latin American countries*" (DEA/69/59). There are no mentions to the "preinvestment fund for the integration of Latin America" in the resolutions of either governors or directors after 1972.

One significant product financed with the Preinvestment fund was the "inventory of physical integration projects" approved in 1969 (ATN/TF-941-VS, TC6910021, DE-146/69) from 1969. "*During 1971 resources of the Fund were used in concluding an inventory of multinational physical infrastructure projects which will prove a valuable tool in efforts to finance physical integration projects. The inventory contains approximately 600 projects, 73 per cent in the transportation field, 11 per cent in electric power, 7 per cent in telecommunications and 9 per cent in the joint use of water basins.*

[55] Proceedings, Board of Governors, 1970, available at eArchives.iadb.org.

Some 80 per cent of the projects have been given cost estimates and these total more than $10 billion [60 billion in 2012 dollars]." [56]

The Fund for the Financing of Technical Cooperation Initiatives for Regional Infrastructure Integration (FIRII)

In the early 2000s, the Presidents of the region created two regional infrastructure initiatives in order to achieve the integration of the region. In their Brasilia meeting in 2000, the South American presidents created the "Iniciativa para la Integración Regional Sudamericana" (IIRSA) with the purpose of hastening physical infrastructure integration and identifying those projects that have higher impact over integration. In parallel, they asked the three regional financial institutions (CAF, FONPLATA, and IDB) to support the initiative. Almost simultaneously, the Presidents of Central America and Mexico created the "*Plan Puebla Panama*" with similar objectives.[57] Both of these initiatives *de facto* emphasized on infrastructure integration particularly transport (roads) and electricity. Similar to the 1967 integration effort, a first objective was to define a list of projects (inventory) for both initiatives and to ensure that there were adequate funds to preinvest in those projects. So here again, similarly to the 1960s experience, the Bank created a specific fund to finance preinvestment studies.

In 2005 the Bank created the "Fund for the Financing of Technical Cooperation for Initiatives for Regional Infrastructure Integration" (FIRII) (GN-2344-4) in order to finance pre-investment of strategic infrastructure integration projects. The Fund was originally endowed with $20 million that would have a contingent recovery modality, thereby ensuring sustainability for a long period.

However, the anticipated demand for FIRII failed to materialize in the first two years. Among the reasons for this lack of demand, Management noted *"[…] the transnational nature of integration projects, which gives rise to complex regulatory issues, and the many stakeholders involved […]*" (GN-2344-7). Following Management's recommendation, the Board eliminated the contingent recovery modality in February 2006 (GN-2344-8).

Between 2006 and December 2011, FIRII received $40 million and approved projects for $30.5 million—all as nonreimbursable technical cooperation. As of September 2012, FIRII has an availability of $14.7 million dollars.

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56 See *Inventario de Proyectos de Integracion Fisica en America Latina*, Banco Interamericano de Desarrollo, 1972. Link. The quotation comes from the 1971 Annual Report of the IDB, p. 31, available at eArchives.

57 For the full details, see OVE's evaluation of the IIRSA initiative (RE-338) and Plan Puebla Panama (RE-350).

CONCLUSION

The preinvestment funds created by the Bank in the 1960s and 2000s show striking similarities. First, the political will of the countries in the region is crucial both in the creation and continuing support of these initiatives. Related to that, it is crucial that ambitious goals such as those proposed by the Presidents are matched with actions (particularly regarding resource allocation) both from the countries themselves and the Bank. Secondly, although the initial intention was to provide mostly loans for multinational projects, both funds ended up providing almost exclusively nonreimbursable technical assistance. The main reason for this is the complexities and costs added for regional projects, which effectively disincentives countries to carry out this work unless a preferential treatment is received.

ANNEX E. SECTOR FACILITY FOR TRANSNATIONAL PROJECTS

In the context of adapting IDB instruments to the changing needs of the region, the Bank created four flexible lending instruments in 2000. The general diagnosis was that the Bank needed to provide a faster response to the needs of the countries. The new four instruments were Innovation Loans (ILs), Multi-phase Program Loans (MPLs), Sector Facilities (SFs), and the Project Preparation and Execution Facility (see GN-2085-2).

Sector facilities were designed to provide fast-track support to "*to carry out pre-defined low-cost and relatively low-risk activities, characterized by their: (i) relatively high impact; (ii) high sector relevance and urgency; (iii) less complex preparation; and (iv) rapid implementation.*"(GN-2085-2, p. 15). There was an overall ceiling of $150 million for sector facilities and an individual ceiling of $5 million per loan. Between 2000 and 2003, sector facilities were created for different topics. In 2000, the education, health, and trade facilities were created. The disaster prevention and the institutional development facilities were created in 2001 and 2002 respectively.

Finally, the transnational infrastructure facility was created in June 2003 (DE-50/03). This facility was set up to finance three main components: i) Development and institutional strengthening of policymaking, regulatory, concession-granting, and supervisory agencies in infrastructure integration; ii) preparation of specific transnational infrastructure projects; and iii) implementation of transnational infrastructure projects. (GN-2085-10).

In 2007, management evaluated the operational implications of the new lending instruments (GN-2085-15). Between 2000 and 2006, there had been 45 projects approved within the sector facility modality, for a total of $182.6 million. Most of the approvals (about 50 percent) went to the institutional development facility with about 25 percent going to the trade facility. The document concluded that "*[t]he demand for education and health is small, <u>for transnational infrastructure nonexistent</u>, and for disaster prevention moderate.*" (GN-2085-15, p.18, underlying added). Between 2007 and 2012, the use of the instrument is reduced even further: In these six years, only 10 new projects for about 50 million dollars were approved.

The report goes on to attribute the limited demand for sector facilities to the fact that these were small in size and that—once approved—they received the same operational treatment than an investment loan. Crucially missing from the discussion of management is the issue of financial conditions. In particular, sector facilities did not receive any preferential treatment in terms of interest rates, commitment fees, grace periods, and amortization periods.

Only one project—border crossings between Peru and Bolivia (PE-L1003)—was ever approved under the sector facility for transnational infrastructure. Sector facilities were eventually eliminated with the reform of the Bank lending instruments in 2011 (GN-2564-3).

ANNEX F: THE TRADE AND INTEGRATION TECHNICAL COOPERATION PORTFOLIO AND ITS MATCH WITH THE PRIORITIES OF THE STRATEGY

Type of intervention	Description (GN-2565-4)	Type of instrument	Total lending (2000-2012)	Total number of operations	Main unit responsible
Software para. 6.5.i	Negotiation and implementation of trade and investment agreements.	Regional technical cooperation (RTC)	US$108 million	447	INT
Software para. 6.5.ii	Export promotion and investment attraction.				
Software para. 6.5.iii	Trade facilitation and customs modernization.				
Software para. 6.5.iv	Expansion of the depth and coverage of private finance	MIF Regional Projects	US$388 million	311	MIF
Software paras. 6.5.v, 6.7	Development of an enabling environment for sustainable and inclusive integration.	Regional public goods	US$67 million	83	INT
Hardware para. 6.6. i	Connecting the transport network.	FIRII, TC, and RTC	US$34 million	46	INE
Hardware para. 6.6. ii	Supporting cost-reducing energy integration.	FIRII, TC, and RTC	US$35 million	59	INE
Hardware para. 6.6. iii	Bridging the digital divide.	Public/Private sector lending			INE
	Other sectors not covered by the strategy.	Other Regional TCs (RTC and special ordinary capital programs).	US$668 million	1,239	Other INE and sectors covered by other departments

INE (transport and energy) includes FIRII and RTCs. None of the RTCs in INE are related to the digital divide, but there are other sectors in INE, such as agriculture and rural development, urban development and housing, education and private firms and SME development.

FIRII (approved amounts)

Energy	US$8,556,000	8 projects
Trade	US$300,000	1 project
Transport	US$21,519,297	23 projects

ANNEX G. TABULATION OF LESSONS LEARNED IN THE STRATEGY DOCUMENT

Lesson learned	Specific lesson	Operational implication of lessons learned	Significant	Factual	Applicable
Software para. 5.3 Advocating new ideas to expand the integration frontier.	"The Bank learned that investing in integration cutting-edge knowledge is key to engage client countries and earn their trust to become a preferred integration partne.r"		YES	MAYBE	NO
Software para. 5.4 Leading in trade-related technical assistance.	There is a statement about the importance of technical assistance. No specific lesson is identified.		NO	NO	NO
Software para. 5.5 Facilitating private sector integration.	There is a statement about the role of the Bank promoting trade facilitation, trade finance, and regional funds. No specific lesson is identified.		NO	NO	NO
Software para. 5.6 Serving as an honest broker in integration initiatives.	"The Bank has learnt that: (i) mobilizing Ministers of Finance is key to bring the integration agenda from the negotiation stages to the implementation phases in which programming public investment is crucial. (ii) the convening power of the Bank is crucial to raise awareness in clients on the multi-sectoral challenges and social related issues of modern integration." The latter is rather a comparative advantage.	"[T]he Bank needs to support the emerging institutional coordination challenges posed by this negotiation-implementation continuum involving several ministries and subnational entities."	YES	MAYBE	YES
Software para. 5.7 Mobilizing the donor community for trade-related support to LAC.	"The Bank has learnt that: (i) Bank initiatives in the area of integration [Aid for Trade and Multidonor AfT] may generate interest in external donors; (ii) these initiatives are a suitable platform to start addressing new issues such as trade and gender and trade and climate change; (iii) there is a need to assign dedicated resources to their development; and (iv) commitment of Senior Management and a critical mass of donors are key at the inception stage." (iii) is not a lesson learned but rather the implication of (i).	"(iii) there is a need to assign dedicated resources to their development." No implications for lessons (ii) and (iv).	MAYBE	MAYBE	MAYBE
Software para. 5.8	The Bank has learned that: (i) the joint operation of the Trade	"(ii) the Bank would benefit from a	YES	MAYBE	YES

Lesson learned	Specific lesson	Operational implication of lessons learned	Significant	Factual	Applicable
Promoting policy dialogue on a long-term regional vision.	and Integration network and other sector networks (e.g. transport, science and technology, etc.) is a valuable instrument to support the emerging multi-faceted integration agenda;	dedicated policy dialogue instrument focused on reaching out to the expanding constituency of stakeholders relevant for today's integration agenda (such as trade, transport, communications, foreign affairs, and finance ministries as well as private sector organizations) and on advancing a Bank-wide integration agenda."			
Software para. 5.9 Building capacity for a critical mass of integration agents.	"From this experience, the Bank has learned that: (i) the allocation of adequate resources to an ambitious capacity building program on integration is a contribution to the development goals of the region valued by clients; participants; (ii) capacity-building is needed not only on a growing list of integration-related thematic topics but, going forward, to nurture the capacity of government officials and private sector representatives to originate, design and execute integration projects, with the goal to unlock the latent demand for regional programs; and (iii) enhanced coordinated action of INT and the Institute for the Integration of Latin America and the Caribbean (INTAL) is a key asset for the Bank as it allows to combine the technical expertise of the former with the convening and logistical capacity, and historical trajectory of the latter, all of which signal the distinctive commitment of the Bank to LAC integration."		MAYBE	NO	NO
Software para. 5.14 Innovating to	"The Bank learnt that: (i) the demand for RPG significantly exceeded the availability of	Increase size. Focus interventions.	YES	YES	YES

Lesson learned	Specific lesson	Operational implication of lessons learned	Significant	Factual	Applicable
finance regional public goods.	funding; (ii) the RPG program could be scaled-up to provide greater incentives for regional cooperation; (iii) effectiveness may be enhanced by reducing the dispersion of projects across sectors and increasing their average size; (iv) the demand-driven focus and innovative proposals of the program may be complemented with proactive support of functional cooperation in areas where the Bank has comparative advantages; (v) a better alignment of the program with the new GCI-9 priorities may generate opportunities to scale-up RPG projects with Bank's lending operations."	Increase the alignment with the Bank's strategies and mandates.			
Hardware paras. 5.10-5.13 A progressive regionalization of infrastructure investment.	"(i) the technical and logistical support provided by the Bank to the integration initiatives is highly valued by clients; (ii) the Bank needs to provide support to the integration hardware and software in an integrated manner, leveraging and providing incentives to coordinate the expertise of different units; (iii) there is a need to design innovative processes, including national and regional programming, aimed at repositioning the countries' portfolio of integration infrastructure; (iv) there is a need to develop new operational approaches suited to the specificity of integration projects; (iv) interventions targeted to address key integration bottlenecks, such as border-crossings, ports, and logistics services, may yield high developmental returns; (v) there is a need to refine project evaluation methodologies, particularly those related to the asymmetric distribution of costs and benefits and the sustainability impact of integration infrastructure; and	"As the IIRSA initiative transitions into a new institutional setting under the guidance of the Union of South American Nations, the Bank may need to retool its support to promoting cross-border investments between countries with asymmetric benefits more effectively and to connect hardware and software investments, particularly in training, good practice dissemination, and regional regulatory reforms."	MAYBE	MAYBE	YES

Lesson learned	Specific lesson	Operational implication of lessons learned	Significant	Factual	Applicable
	(vi) the support with non-financial instruments is imperative to underpin consensus among countries, finance pre-investment and elevate the institutional profile of hardware integration initiatives.”				

ANNEX H. COMPARISON OF THE 2003 AND 2011 INTEGRATION STRATEGIES

Area	2003 strategy	2011 strategy
Objectives	1. Guide the institution's support for the creation of RPGs, specifically *regional integration* and *regional cooperation*. 2. The broader aim of regional integration and cooperation is to produce desirable outcomes that are difficult, if not impossible, for individual nations to achieve on their own.	The goal of this strategy is to increase and sharpen the Bank's contribution to a competitive LAC global and regional integration. Priorities: 1. Consolidate the knowledge foundations of the integration agenda. 2. Strengthen the regional capacity to manage modern integration initiatives. 3. Build regional additionality into the Bank's operations in key sovereign and non-sovereign sectors (software and hardware *continuum*). 4. Mainstream integration into the Bank's operational programs (through non-financial and financial activities).
Diagnosis		
Lessons learned	LAC countries have been unable to fully tap the Bank's integration support instruments, particularly its financial resources. In regional programming exercises in the past there was no attempt to bring the full range of these resources to bear to advance integration initiatives, for several reasons: 1. The reliance on regional technical cooperation funding in subregional strategy implementation. 2. Scant interface between country and regional programming and no thematic regional programs as an adjunct to the traditional subregional exercise. 3. Insufficient connection between programming processes and project generation in the Bank. - Increasing of the private sector participation mainly in infrastructure projects. The Bank's integration support has been affected by the reduction in nonreimbursable technical cooperation funding available (FSO net income), diminishing the Bank's capacity to offer the kind of support it had been providing for years to regional integration institutions and their programs.	As opposite from the previous strategy that focused on RPGs, the GCI-9 calls for three changes in focus: 1. Broaden the scope of integration interventions including not only regional but also global integration. 2. Mainstream integration into the lending activity of the Bank. Achieve greater coordination among Bank's sector strategies of all units that hold the potential to contribute to integration outcomes. - Lessons learned from software (mainly trade initiatives) - Lessons learned from hardware (OVE evaluation on IIRSA and PPP) - Lessons learned from RPGs (demand is greater than supply, RPGs could be scaled-up to provide greater incentives for regional cooperation, effectiveness may be enhanced by reducing the dispersion of projects across sectors and increasing their average size, demand-driven focus and innovative proposals of the program may be complemented with proactive support of functional cooperation, and a better alignment of the program with the new GCI-9 priorities may generate opportunities to scale-up RPG projects with Bank's lending

Area	2003 strategy	2011 strategy
		operations).
Areas for Bank action	1. Consolidation of regional markets: to preserve the gains achieved thus far and continue to enhance liberalization processes (support trade agreements not only within the region, but also North-South agreements, FTAA with the EU and Asia, and strengthen countries' positions in multilateral forums like the WTP Doha Round). 2. Promoting regional infrastructure: The Bank has a wealth of experience in support for country infrastructure projects but needs to build a regional perspective into such operations, with attention to their social an environmental impacts (continue the support for national infrastructure but building a regional dimension, harmonizing and modernizing regulatory frameworks and standards, take the lead and offer support via the IIRSA and PPP in areas such as short sea shipping, air transport, energy, communications, and border crossing). 3. Institution-strengthening: assist in the evaluation, strengthening, and rationalization of subregional and/or regional institutional frameworks to help advance integration processes and ease the transition toward free trade. Continue to collaborate in strengthening national institutions that are the counterparts for integration processes. 4. Other regional public goods: capturing externalities to improve competitiveness (natural resources initiatives, biodiversity protection, coordinated regional action on mitigation issues, disaster prevention, financial stability, integrated development of border regions, and exchange of ideas of senior officials).	**Software** 1. Negotiation and implementation of trade and investment agreements. 2. Export trade promotion and investment attraction. 3. Trade facilitation and customs modernization. 4. Expansion of the depth and coverage of private finance. 5. Development of an enabling environment for sustainable and inclusive integration. **Hardware** 1. Connecting transport network. 2. Supporting cost-reducing energy integration. 3. Bridging the digital divide. **RPGs** Address market and coordination failures. They need incentives to prioritize regional activities over national investments.
Instruments	**Financial products** 1. Regional technical cooperation: it makes sense to prioritize the use of these funds, to the extent possible, for programs supporting large-scale plurilateral, multipartner integration and cooperation initiatives like IIRSA, PPP, FTAA, EU-LAC. 2. Country lending: Add regional integration and trade support programs to country loan pipelines. 3. Special lending in support of trade and integration: The Trade Sector	Instead of focusing on the development of new instruments, the proposed integration compact is based on the notion that the Bank should meet the lending target and development goals mandated by the GCI-9 by means of deploying a smart-mix of existing instruments. **Financial instruments** 1. Loans (national and NSG for private sector) 2. Guarantees. 3. Grants (both for financial and non-financial instruments. Establishment of

Area	2003 strategy	2011 strategy
	Facility should continue to operate and be given the resources needed to meet the heavy demand associated with the requirements of trade agreements. 4. Regional infrastructure lending: increasing incentives for regional infrastructure investment. Bank actions (through the private sector division) should facilitate private sector participation in integration infrastructure, particularly through concession agreements. 5. Multilateral Investment Fund (MIF): channel this support through subregionally organized programs where there is measure of similarity between problems, capacities, interests and challenges. **Nonfinancial products** 1. Regional policy dialogue 2. Policy-oriented research 3. Special integration initiatives with its three components (policy papers, support for trade liberalization impact assessments, and public education forums on integration and globalization). 4. Annual meetings of experts. 5. Use of country offices to organize countries and donors for structured evaluation processes to assess trade capacity constraints. 6. Collaboration with staff from subregional banks.	new platforms such as a Strategic Thematic Fund on Integration. Scaling up the availability of OC grant funding, complementing it with a multi-donor Regional Infrastructure Integration Fund) **Non-financial instruments** 1. Contributions to the region's long-term integration initiatives. 2. Policy research 3. Policy dialogue 4. Capacity building (high level executing training, short-term policy advisory services, and support to project identification, design, monitoring and evaluation). 4. Regional Programming (alignment of various regional, national, and sector constituencies in the absence of a clearly defined "regional counterpart," faces multiple overlapping thematic agendas, combine a definition of priorities, honest broker. Mainstreaming integration by identifying a pipeline of integration projects). 5. Incentives for the development of integration programs.
Implementation	The Bank's tool to help allocate these instruments is the Regional programming papers.	**Framework outline for implementation** 1. Management will seek to ensure that Bank's responsible units for implementing the strategy are adequately resourced. 2. Formal intra-institutional coordination activities will be undertaken in order to strengthen the Bank's support to project-based regional integration initiatives. 3. A wide set of communication and visualization tools will be used in a systematic and timely manner to raise the profile of the Bank's work on integration.
Action Plan	**Financial products** 1. Prioritize RTC for programs to support large-scale integration and cooperation initiatives. 2. Encourage countries to request more country loans for programs to support regional integration and trade. 3. Increase the resources of the Trade Sector Facility to meet the demand. 4. Explore the implementation of	**Non-financial instruments** 1. Strategic initiatives: prioritize: subregional formal integration initiatives such as IIRSA and PM. 2. Applied research: developing a bi-annual flagship publication on selected integration topics, and by maintaining and updating a comprehensive data hub (INTrade). 3. Policy dialogue: institutionalize the role

Area	2003 strategy	2011 strategy
	integration sector lending. 5. Enhance incentives for regional infrastructure investment. 6. Improve MIF's trade and investment cluster. 7. Use MIF to help the private sector and labor unions understand the obligations emanating from integration and trade initiatives and to prepare companies. **Nonfinancial products** 1. Continue supporting the Regional Policy Dialogue 2. Promote policy-oriented research 3. Extend the special integration initiative to at least 2004. 4. Organize annual meetings of national and regional experts and officials 5. Organize structured evaluations of trade capacity constraints.	of INT as Secretariat of the Regional Finance Ministers' annual meeting, Regional Policy Dialogue, coordinate with VPP private sector meetings, and provide support to VPC on ongoing integration initiatives through the Integration Strategy Papers. 4. Capacity building: developed by INT a Capacity Building Program on Integration in collaboration with INE, and other relevant units. The Bank will provide capacity building to strengthen the physical integration initiatives, such as IIRSA, led by IIRSA/COSIPLAN, the PM, WCO, WTO and role of the INTAL. 5. Programming: engage public and private sector counterparts in areas related to integration, foment the integration agenda into national development strategies, undertake awareness-raising meetings in client countries, an identify a pipeline of integration. **Financial instruments** 1. Grants: scaling-up the availability of grant resources, improving efficiency and coordination of the Bank's grant windows to promote complementarily, particularly between OC and resources entrusted to the Bank by donors. 2. Loans and guarantees: focus on the Bank's standard instruments that are programmed and executed nationally: policy-based loans to support national policy reforms that facilitate integration, national investment loans designed to address cross-border externalities to the extent possible, and loans and guarantees to the private sector to finance projects with multi-national beneficiaries.
Indicators	**Outputs** 1. Number and volume of loan approvals relating to regional integration. 2. Number and volume of loan approvals under the Trade Sector Facility. 3. Number of country operations containing a regional component or thrust. 4. Number of TC operations supporting regional integration. 5. Number of nonfinancial products deployed in the integration field. 6. Number of evaluations and sector performance reviews. 7. By 2004, there is to be a section on regional integration in the Bank's	**Regional development goals** 1. Trade openness (trade as percentage of GDP) 2. Intraregional trade in LAC as a percent of total merchandise trade. 3. FDI net inflows as a percent of GDP. **Outputs** 1. Number of public trade officials and private entrepreneurs trained in trade and investment. 2. Regional and sub-regional integration agreements and cooperation initiatives supported. 3. Number of cross border and transnational projects supported. 4. Number of international trade

Area	2003 strategy	2011 strategy
	country strategies. **Outcomes** 1. Evaluations of projects involving regional integration. 2. OVE evaluations of the various programming processes and their implementation. **Impacts** 1. Lowering of trade barriers. 2. Composition, distribution and levels of trade and intraregional trade and commercial interdependence. 3. Participation of smaller economies. 4. Attraction to foreign investment. 5. Indicators of macroeconomic convergence.	transactions financed. 5. Mobilization volume by NSG financed project/companies.
Monitoring and evaluation	The strategy will be evaluated three years after its approval.	Management will incorporate lessons learned from the evaluation undertaken by OVE of projects that feature additional benefits to a country from having a coordinated approach with other countries. Management will monitor progress towards the implementation at two levels: expected output contributions and regional development goals related to regional and global integration.

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ANNEX I. STAFF SURVEY

		Vice Presidency for Countries		
How Familiar are you with the Strategy	Do not know the document**		*45*	
	Heard of the document		58	
	Read parts of the document		42	
	Read and know the doocum.		16	
	Total		**161**	
How influential is the strategy likely to be in selecting and designing new operations for the period 2013-2015	No influence		5	
	Minor influence		26	
	Some influence		50	
	Prominent		29	
	Total		**110**	
		Country strategies & programming	Country dialogue	Project preparation
Used the Strategy during the last year in the following activities	Never	57	59	64
	Sporadically	29	28	25
	Often	16	19	15
	On a regular vasis	8	4	6
	Total	**110**	**110**	**110**

			Integration and Trade Sector			
How Familiar are you with the Strategy	Do not know the document**			*1*		
	Heard of the document			0		
	Read parts of the document			2		
	Read and know the doocum.			10		
	Total			**13**		
How influential is the strategy likely to be in selecting and designing new operations for the period 2013-2015	No influence			0		
	Minor influence			3		
	Some influence			4		
	Prominent			4		
	Total			**11**		
			Lending Projects	Technical cooperation	Analytical work	Country Dialogue
Used the Strategy during the last year in the following activities	Never	Not at all	2	0	1	2
	Sporadically	Little	3	2	2	4
	Often	Some	1	2	7	0
	On a regular vasis	A lot	5	7	1	5
	Total	**Total**	**11**	**11**	**11**	**11**

Management Comments

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

Mid-Term Evaluation of IDB-9 Commitments
Background Paper: Competitive Regional and Global Integration Strategy
Management Comments

Mid-Term Evaluation of IDB-9 Commitments
Background Paper: Competitive Regional and Global Integration Strategy
Management Comments

I. INTRODUCTION

1.1 Management welcomes this evaluation and thanks the Office of Evaluation and Oversight's (OVE) for the constructive dialogue with Management and staff during its preparation. The paper's findings and suggestions will help sharpen the Bank's contribution to the regional and global integration of Latin America and the Caribbean, the main goal of its "Strategy to Support Competitive Regional and Global Integration" (henceforth, the Strategy)

1.2 Management is pleased to see that some of the comments and suggestions provided to OVE on the earlier draft of the paper have been incorporated in this final version, in particular, those related to the institutional changes in structure and business practices undertaken as part of the implementation of the Strategy.

II. OVERALL FINDINGS AND SUGGESTIONS

2.1 The review provides good insights into the challenges associated with the role of multilateral development banks (MDBs) in supporting integration, the history of the Bank in this field, and the need to explore instruments that make borrowing for integration more attractive to client countries.

2.2 Management welcomes OVE's acknowledgement of the Bank's prominent role in supporting integration with non-financial products (research, capacity building and policy dialogue). We fully agree with the paper's conclusion that the major comparative advantages of the Bank were correctly identified in the Strategy. It follows that Management and OVE agree on one central tenet of the Strategy, namely the strategic decision to increase the value of investment projects in the integration *hardware* with the provision of cutting-edge expertise and lending aimed at strengthening the integration *software*.

2.3 While we broadly agree with OVE's conclusions and suggestions, we believe that the review could have benefited from a broader scope. OVE's review emphasized the assessment of the Bank's regional programs, while the Strategy focuses on "integration" projects, which include regional programs but also - necessarily – national interventions. In this regard, Management would like to point out that, as acknowledged by OVE, the Governors' mandate is not limited to regional programs. It refers explicitly to trade and infrastructure interventions, to non-financial support and large investment projects, and to coordination of national operations with cross-border externalities and multi-country projects.

2.4 Management understands the rationale behind OVE's conclusions on the benefits of focusing scarce resources to the support of regional projects (expressed in other OVE documents: RE-338, RE-350 y RE-415). However, the Governors' mandate was

broader, and consequently, so was Management's response, as reflected in the Strategy. As such, Management believes that only the Governors could address OVE's suggestion to "define the new strategic approach to regional integration based on risk appetite".

2.5 Management agrees with OVE on the need to have an accurate, clear, transparent and consistent system to identify and classify national and regional operations that contribute to the integration lending target. As acknowledged by OVE, designing this type of system is challenging in conceptual and strategic terms - as demonstrated by the experience of other multilateral Banks. In addition, its implementation also requires a capillary transformation of the institutional culture. As established in the Strategy's Action Plan, the Bank is already working on and testing such an operational classification system. In designing that system, Management is aware of concerns about "creative accounting" and has sought guidance from the Board of Directors on this matter in formal sessions and in technical briefing meetings.

III. LOOKING FORWARD

3.1 Management welcomes this evaluation and will take into consideration OVE's inputs going forward. Indeed, the Bank has already started to work in the direction suggested by OVE. For example, work is under way to promote collaboration across Bank units in delivering the integration program. Other efforts are proceeding to define an operational classification system, implementing new programming modalities, and developing both financial and non-financial instruments and products that will add value to the Bank's integration lending. Management looks forward to working with the Board of Governors and the Board of Directors to follow up on OVE's suggestions.

3.3 Management would also like to point out that its response to OVE's observations and conclusions on the quality of the Strategy (relevance of the strategic documents, goals alignment, risks assessment, quality of indicators, etc.) is contained in Management's consolidated response to OVE's IDB-9 Overview Report.

3.4 Finally, additional clarifications were sent to OVE under separate cover.