INTER-AMERICAN DEVELOPMENT BANK



TOWARD SUSTAINABLE AND EQUITABLE DEVELOPMENT

SECTOR STRATEGIES FOR LATIN AMERICA AND THE CARIBBEAN

- SUSTAINABLE ECONOMIC GROWTH
- POVERTY REDUCTION AND PROMOTION OF SOCIAL EQUITY
- MODERNIZATION OF THE STATE
- SOCIAL DEVELOPMENT
- COMPETITIVENESS
- REGIONAL INTEGRATION
- ENVIRONMENT

ht © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

TOWARD SUSTAINABLE AND EQUITABLE DEVELOPMENT

SECTOR STRATEGIES FOR LATIN AMERICA AND THE CARIBBEAN



Inter-American Development Bank

Washington, D.C.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Cataloging-in-Publication data provided by the
Inter-American Development Bank
Felipe Herrera Library

Toward sustainable and equitable development : sector strategies for Latin America and the Caribbean.

p. cm.
"This book was prepared under the direction of Carlos M. Jarque ... who [also] prepared the first chapter"—t.p. verso.

"...Bank's sector strategies, which were approved by the Board of Executive Directors on July 23, 2003"—t.p. verso

1. Sustainable development—Latin America. 2. Economic development. 3. Poverty. 4. Administrative agencies—Reorganization. 5. Competition. 6. Latin America—Economic integration. 7. Inter-American Development Bank. I. Jarque, Carlos M. II. Inter-American Development Bank. Sustainable Development Dept.

333.715 H722 —dc21

This book was prepared under the direction of Carlos M. Jarque, Manager of the Sustainable Development Department, who also drafted the first chapter. The following chapters present the Bank's sector strategies, which were approved by the Board of Executive Directors on July 23, 2003. Inter-departmental working groups were in charge of the elaboration of each strategy, as indicated in each chapter.

February 2004

Inter-American Development Bank
1300 New York Avenue, NW
Washington, D.C. 20577
USA

http://www.iadb.org

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

CONTENTS



Forewod 1

Toward Sustainable and Equitable Development 5
- Introduction
- The New Strategies and the IDB's Renewed Commitment to Sustainable and Equitable Development
- General Overview of the New Sector Strategies

■ **Sustainable Economic Growth** 31
- Objective
- Diagnosis
- Lessons Learned
- Areas for Bank Action
- Options for Bank Services and Implementation Guidelines
- Monitoring, Evaluation, and Performance Indicators

■ **Poverty Reduction and Promotion of Social Equity** 63
- Objective
- Diagnosis
- Lessons Learned
- Areas for Bank Actions
- Options for Bank Services and Implementation Guidelines
- Monitoring, Evaluation, and Performance Indicators

■ **Modernization of the State** 101
- Objective
- Diagnosis
- Lessons Learned
- Areas for Bank Action
- Options for Bank Services and Implementation Guidelines
- Monitoring, Evaluation, and Performance Indicators

■ **Social Development** 137
- Objective
- Diagnosis
- Lessons Learned
- Areas for Bank Action
- Options for Bank Services and Implementation Guidelines
- Monitoring, Evaluation, and Performance Indicators

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

■ **Competitiveness** **181**
Objective
Diagnosis
Lessons Learned
Areas for Bank Action
Options for Bank Services and Implementation Guidelines
Monitoring, Evaluation, and Performance Indicators

■ **Regional Integration** **219**
Objective
Diagnosis
Lessons Learned
Areas for Bank Action
Options for Bank Services and Implementation Guidelines
Monitoring, Evaluation, and Performance Indicators

■ **Environment** **251**
Objective
Diagnosis
Lessons Learned
Areas for Bank Action
Options for Bank Services and Implementation Guidelines
Monitoring, Evaluation, and Performance Indicators

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

FOREWORD

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

After a decade of significant reforms and efforts to promote development, the countries of Latin America and the Caribbean find themselves at the crossroads. In spite of low economic growth, an unfavorable international situation, unyielding levels of social inequality and growing expectations on the part of their citizens, the countries of the region remain committed to upholding macroeconomic equilibrium, mobilizing private capital, searching for new export markets, improving the delivery of their public services, reducing poverty and pushing ahead with social reform. The Inter-American Development Bank seeks to continue supporting countries in these efforts and to play a substantive role based on its specialized knowledge of the region and its experience in the area of economic and social development. The array of new strategies presented in this volume represents a recent undertaking by the Bank to provide an analytical framework as well as a signal of the institution's priorities in light of the needs of the region.

Consistent with the Bank's founding principles of promoting the economic and social development of its borrowing member states, individually and collectively, these strategies highlight Sustainable Economic Growth and Poverty Reduction and the Promotion of Social Equity as fundamental objectives of the Bank's activities in these countries. They acknowledge that economic growth is a necessary but insufficient condition for reducing poverty, stressing the importance of specific actions to ensure that the benefits of growth reach the poorest and most excluded. They also acknowledge that economic growth does not limit itself to the macroeconomic situation. It is necessary to pay attention to key microeconomic issues, such as the productive conditions and human capital of the poorest, the development of social capital, institutional management, the application of technology to production, the development of capacities, a favorable investment climate, and the competitiveness of businesses and specific economic sectors. The general lines of action for achieving these objectives constitute guidelines for the Bank's specific activities in its four areas of comparative advantage: Competitiveness, Social Development, Regional Integration and Modernization of the State, taking into account in each case the sustainability of natural capital.

We trust that this new strategic framework will become an effective instrument in guiding the dialogue between the Bank and countries toward defining priorities in the lending and non-lending services required, applied in line with the specific needs and conditions in each country or group of countries. It will enable a more efficient use of the Bank's resources, directing them toward those areas where they can have most impact on development.

Similarly, we hope that these new strategies, that pick up on the development policy consensus between the Bank, its member countries, the academic world and civil society, will be of use for our countries and for all those interested in the sustainable development of Latin America and the Caribbean.

Enrique V. Iglesias
President
Inter-American Development Bank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

TOWARD SUSTAINABLE AND EQUITABLE DEVELOPMENT

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This chapter was written by Carlos M. Jarque, chair of the Inter-departmental Group on Sector Strategies and Review of IDB Policies. Its content relies on the summaries of the seven strategy documents and the Comprehensive Implementation Plan for the strategies. Each strategy was produced by a specific team coordinated by C. Bouillon, G. Yamada, E. Lora, M. Buvinic, E. Jarquín, F. Acevedo, R. Devlin, A. Vives, W. Arensberg, R. Quiroga, L. Fierro and P. Roldán.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

INTRODUCTION



Over recent decades, the countries of Latin America and the Caribbean have exerted great efforts that have enabled them to reform their economies, achieve macroeconomic stability, improve their social indicators and promote democracy.

In the *economic ambit*, countries reduced tariffs and eliminated restrictions on export and import of tradable goods and services. They simplified the legal and administrative aspects of tax collecting, making the tax system more neutral and in most cases raising tax revenue. They liberalized the financial sector, reducing or eliminating subsidized credits, freeing interest rates, reducing reserve requirements, building up modern regulatory systems, and opening up markets to foreign capital and financial institutions. They made great efforts toward privatizing state companies, especially in the area of services and banking.

In most of these areas, with the exception of labor markets, the reforms were speedy and profound. Within five years, a group of countries in the region did more to achieve reform in the areas of international trade, financial markets and privatization than was achieved in three decades in East Asia. These reforms produced important results in the majority of countries, especially during the first half of the 1990s. Inflation was reduced to single digits, average tariffs were lowered from more than 40 percent to around 10 percent, 800 public companies were privatized between 1988 and 1997, capital inflows rose from US$17 billion in 1990 to US$87 billion in 1997, and the volume of trade and investment multiplied.

Furthermore, the countries of Latin America and the Caribbean achieved important advances in their social indicators. The region's performance in the Human Development Index of the United Nations Development Program (UNDP) rose from 0.66 in 1975 to more than 0.76 in 2000. Such advances are also evident in the region's progress toward achieving the Millennium Development Goals (MDGs) with regard to social indicators, particularly in primary education and gender equity in school enrollment.

Regarding relations between the State and citizens, democratic regimes have been established in the countries of the region over the last two decades. This has led to significant improvements with respect to human rights protection, freedom of expression, the exercise of individual political liberties and expansion in the opportunities for citizens to take part in public decision making. Moreover, great efforts have been made to strengthen the rule of law and the separation of powers, improve the regulatory capacities of the State and provide the technical expertise and professional independence to those sectors responsible for macroeconomic management, supervision and control. Also within the region, there has been a wide move toward decentralization, bringing government and the people closer together and deepening democracy.

However, data provided by *Latinobarómetro 2003* is indicative, showing that while the majority of people state their support for democracy, only 29 percent are satisfied by it. The broad wave of democratization has taken place at a time when the economic and social

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

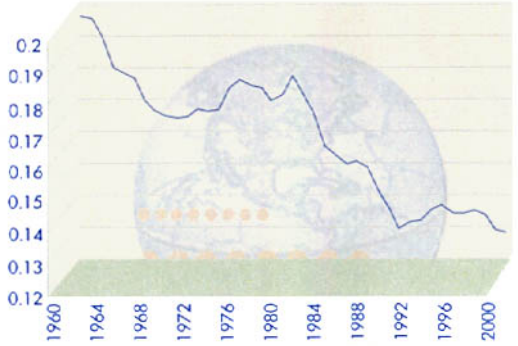
advances have been insufficient. Of course people want freedoms, respect for human rights, to be able to elect their own governments, but they also want well-paid jobs, access to justice, health and education, among other welfare goals. So, despite the progress made (in economic reform, macroeconomic stability, in social indicators, in democracy and the rule of law), the mood is still one of dissatisfaction, a mood influenced by (among other things) the region's disappointing performance in achieving sustainable economic growth and reducing poverty and marginalization.

With the exception of Africa, all other regions of the world achieved better results with regard to *economic growth*. Indeed, the region's per capita income as a percentage of that of high income countries fell from 20 percent in the 1950s to 13 percent now (see graph 1). Similarly, Latin America's position in terms of per capita income has fallen from second in the 1950s to fifth now, below that of South East Asia, the Middle East and Eastern Europe, exceeding only that of the rest of Asia and Africa. Although growth in per capita income picked up in the 1990s after the so-called "lost decade," the annual average growth rate reached only 1.5 percent. If this rate does not improve, it will take nearly a century to achieve the current levels of per capita income of developed countries.

On the subject of *poverty reduction*, various studies agree that there was around a 10 percent reduction in the proportion of poor people compared to levels at the beginning of the 1990s.[1] Nevertheless, owing to population growth, the absolute number of poor people did not decline over the past decade. Measured by the percentage of people with incomes below $2 a day in terms of purchasing power parity (PPP), poverty afflicts more than one-third of the population of the region at the outset of the 21st century, some 180 million inhabitants.[2] The incidence of poverty today is even greater than at the beginning of the 1980s, and recent evidence suggests that the modest advances made in the 1990s have been reversed by the economic slowdown and crises in a number of countries at the beginning of the first decade of the new century.

GRAPH 1

Per Capita Gross Domestic Product in Latin America and the Caribbean as a Proportion of High-income Countries
(1995 US$)



Source: *World Development Indicators 2003*.

The speed at which poverty was reduced in the 1990s is insufficient to achieve the Millennium Development Goal of reducing the proportion of population living in extreme poverty by 50 percent between 1990 and 2015. The percentage of the poor with daily incomes of under $1 in PPP terms fell by around 10 percent (from 19 to 17 percent) while the percentage of poor people with incomes of less than $2 a day fell by around 13 percent. Graph 2 shows how the region is advancing toward the target and the trend that would be required to meet it by 2015.

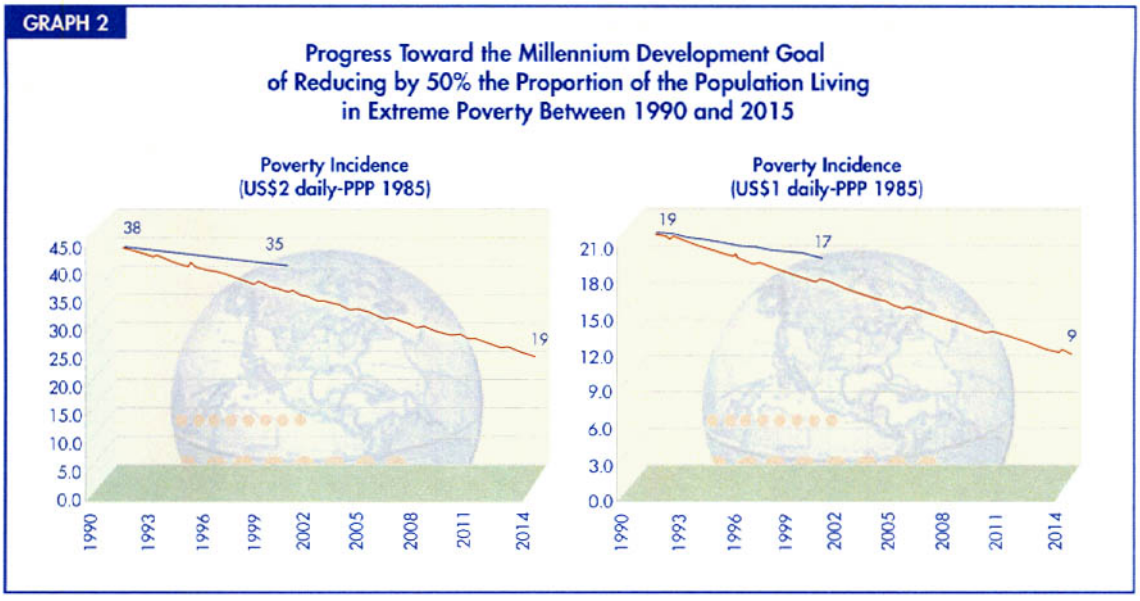
---

[1] Estimation of poverty trends is sensitive to methodological problems. Still, recent studies using different methodological approaches agree that the incidence of poverty in the region fell moderately during the 1990s.

[2] The estimate is based on household surveys in the region. The $2 a day income line (in PPP terms) is considered appropriate for comparing poverty between the countries in the region given their relative levels of economic development. The base year is 1985.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

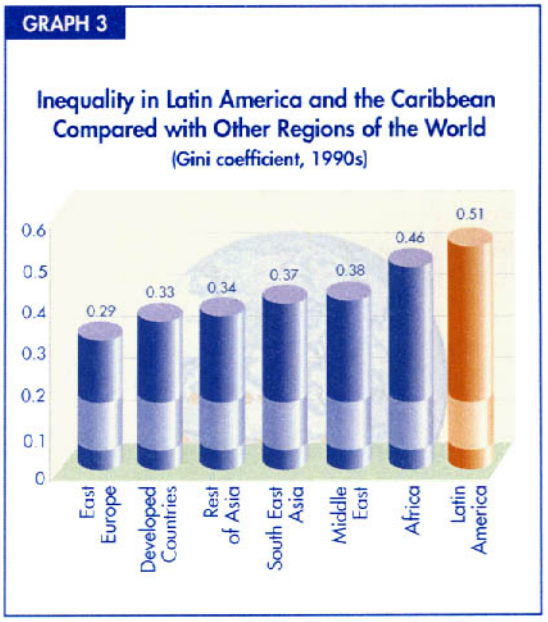
GRAPH 2



Together with low economic growth, one of the limitations in reducing poverty in Latin America and the Caribbean has been the high level of *inequality*. The countries of the region are among the most unequal in the world (see graph 3) and the situation did not improve in the 1990s. Renewed economic growth during the course of the decade had a limited impact on poverty because of the increase in wage and income inequalities in various countries, associated with technological change with a bias toward higher demand for skilled labor, and the transitory effects of trade and financial liberalization. Income inequality, measured by the Gini coefficient, increased or remained the same in most countries in the region between 1990 and 2000. As a result, at the end of the 1990s, the richest 20 percent of the population received around 60 percent of the income, while the poorest 20 percent received only around 3 percent. In the majority of countries, inequality is higher than the levels that would be expected from their per capita income levels. High rates of inequality place limits on the reduction of poverty. In many countries in Latin America, the reduction in poverty that would have resulted from economic growth was offset by the increase in poverty associated with higher income inequality, and by the fact that gains from growth were higher in those areas better integrated into global markets.

Lurking behind income inequality is a marked inequality in the distribution of assets, including education, land and credit.

GRAPH 3



Source: Inter-American Development Bank and *World Development Report 2000/2001*

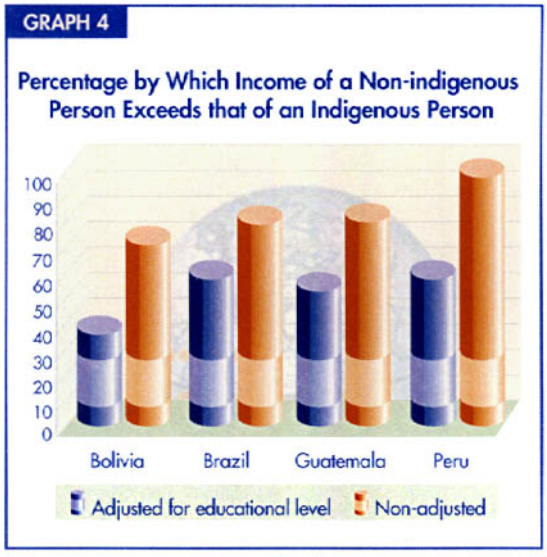
Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Currently, the poorest 20 percent of the population receives an average of four years of formal schooling, while the richest 20 percent receives ten years. In those countries for which there is available information, the children of poor parents build up more disadvantages (or development "failures" including school drop-out and youth unemployment) more quickly than those of rich families. This limits even more the chances of children of poor parents being integrated into a competitive labor market and escaping poverty. In Brazil, for instance, 64 percent of children in the poorest quintile accumulate one or more development "failures" by the time they reach 18, compared with only 15 percent in the richest quintile.

Further increasing the problems of asset inequality are those of social exclusion and discrimination. Graph 4 shows, for a group of selected countries, the percentage by which salaries of non-indigenous people exceed other groups. They are between 70 and 100 percent higher (i.e., double). Even adjusting these figures for education levels (i.e., by comparing wage levels for the same education levels), the percentages vary between 30 and 50 percent. This difference is associated with various factors, including labor market discrimination. Those people who are socially excluded on the basis of gender, age, race, ethnic origin, disability or their condition as migrants live in conditions of poverty, suffer multiple disadvantages, stigma and discrimination, and come last in advancing toward meeting the MDGs.

Economic growth over the past decade had only a limited impact on reducing poverty and social inequality. This is because it was insufficient, highly volatile and had a limited capacity for creating adequate employment and raising the income of less qualified workers. Simultaneously, the persistent levels of poverty, inequality and exclusion for a significant proportion of the population continued to limit the potential for social well-being and for recovering and sustaining higher rates of economic growth. All this has an impact on the extent to which the reforms are socially accepted, on the perception of the social gains achieved from democracy, on the degree of satisfaction among citizens about the state's ability to respond to their basic needs, and on the overall evaluation of the efficacy of the social contract. Naturally, the social dividend is very important for the legitimacy of the reforms and for democracy itself.

GRAPH 4



Source: IDB

An array of factors, which are mutually reinforcing, help explain the slow rates of economic growth and the high levels of poverty and inequality in the region.

First, while there have been important advances in *public policy* there are still significant deficiencies. For instance, some countries in the region are still pursuing inappropriate *macroeconomic policies.* These contribute to economic insecurity and low employment growth, generating substantial declines in income and price instability, providing disincentives to investment, and eroding capital accumulation. For example, in the 1998–2002 period, four countries had inflation rates of over 20 percent in one or another year. At the end of 2001, eleven of the 26 countries had a

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

public debt of over 50 percent of GDP. One of the most important lessons learned in the region over the past decade with regard to ensuring macroeconomic stability is the need for adequate budgetary and fiscal management arrangements (especially within a context of insufficient fiscal resources and incipient decentralization in various countries), and for foreign exchange regimes appropriate to the economic structures of the countries.

Moreover, though some countries in the region have made important progress in the area of policies for social development and poverty reduction, many still have deficiencies. These include the lack of a multi-dimensional, comprehensive and strategic approach; insufficient allocation of resources to social development priorities; failures in targeting programs; insufficient attention to the problem of inequity; inadequate attention to social protection mechanisms; insufficient attention to the dimensions of gender and social exclusion on grounds of race and ethnicity; limited levels of citizen participation in defining projects; and deficiencies in the methods used for program monitoring and evaluation. The lessons learned over the last decade point to the importance of institutionalized social and poverty reduction policies that enable more consistent efforts and ensure both adequate resources and a framework appropriate to the design and efficient implementation of social development programs. Public policy needs to encompass visions for the medium and long term.

Second, the *poor quality of public institutions,* which among other things has reduced the effectiveness of reforms, prevented people and their businesses from benefiting fully from their productive efforts, and limited the capacity for government action on behalf of the poorest. It has also precluded a large number of citizens from being able to access basic rights and justice. In spite of the progress made in protecting human rights, political liberties and the separation of powers, important weaknesses persist in the region questioning the political and institutional strength of democratic regimes. These include deficiencies in the political institutions that ensure the legitimacy of and trust in the democratic system (such as political parties, parliaments and the judicial branch); weaknesses in defining and protecting property rights and the rule of law in general; absence of a career civil service in different levels of government; weaknesses in the process of decentralization; lack of transparency that nourishes perceptions of corruption; and deficiencies in those institutions that regulate, raise taxes and manage public expenditure. Graph 5 shows some indicators with respect to some of these weaknesses, drawing comparisons with developed countries.

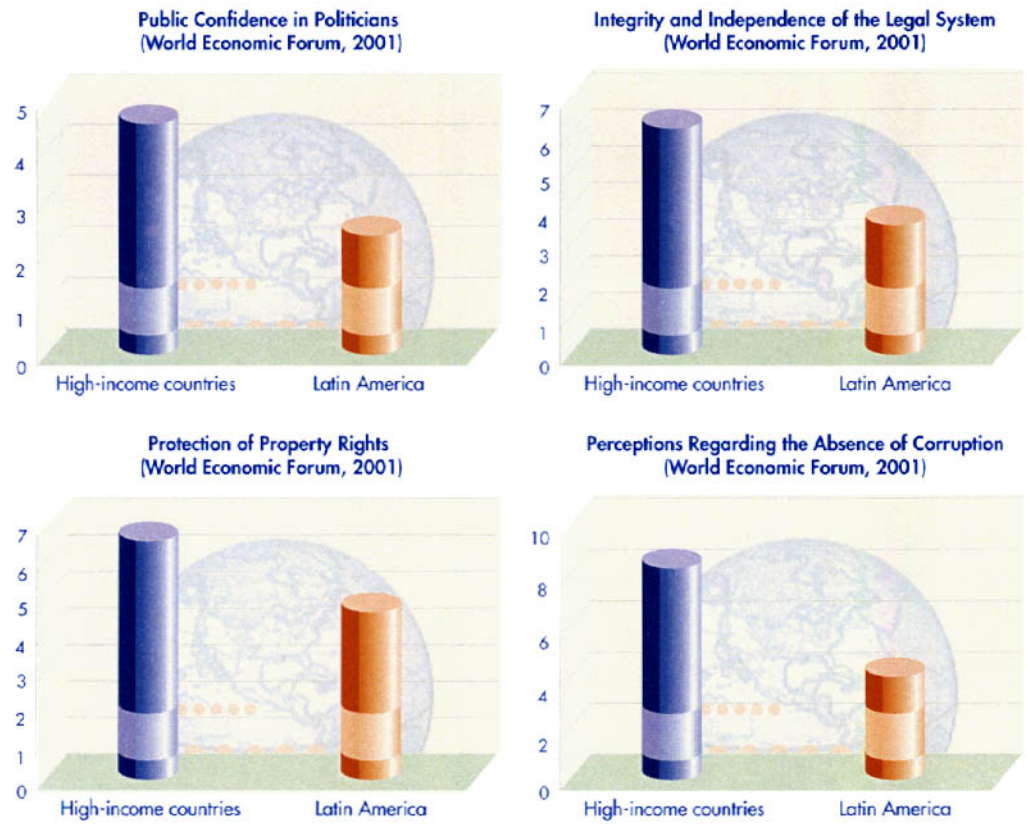
In the debate over development, there is an evolution from the dimension of democratic governance as something to be desired (for the intrinsic value of citizen freedoms and respect for human rights) toward that of democratic governance as a necessity. There has been progress in the region with respect to democracy as a political regime, but less so to democracy as a political system based on widespread participation, the rule of law, and efficient institutions. One lesson learned in this respect, resulting from international experience, is that a country may have institutions of widely varying quality, and that this needs to be taken into account in order to target efforts for institutional change. Typically, Latin American countries have much better institutions for market regulation than for the rule of law and control of corruption. Institutional reform must be carried out within a framework of democratic governance.

Third is the relatively low access to *financial services,* which affects the competitiveness of productive activities in the region. Although Latin America and the Caribbean as a whole has seen significant progress in reaching and sometimes surpassing international standards, there are a number of countries that have not

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

GRAPH 5

Indicators of Political and Institutional Strength
Latin America and Developed Countries



made progress in supervision, regulation, coverage, and the independence and autonomy of regulatory agencies. This increases economic vulnerability to external shocks and limits the capacity of the financial sector to meet the demand for financial resources from, among others, micro, small and medium-sized businesses, and independent producers (especially those in rural areas). Domestic credit provided by the region's banking sector is no more than 39 percent of GDP, lower than in all other parts of the world with the exception of the rest of Europe and Central Asia (see graph 6). Moreover, access to forms of finance other than bank credit is limited, and markets for bonds and securities have only recently begun to develop in most countries. Market capitalization in the region reaches about 33 percent of GDP, as opposed to 104 percent for high-income countries. One lesson learned in this field is the importance of developing financial systems and local capital markets that help reduce vulnerability. Another is that not all international arrangements are necessarily applicable to all countries. For instance, the recently proposed modifications to the Basel Accord involve internal systems for risk evaluation that simply do not exist in a number of countries and pose challenges that require additional follow up. They also have implications for access to finance on the part of small and medium-sized businesses. Similarly, the region still has a long way to go in the regulation and promotion of microfinance, which

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

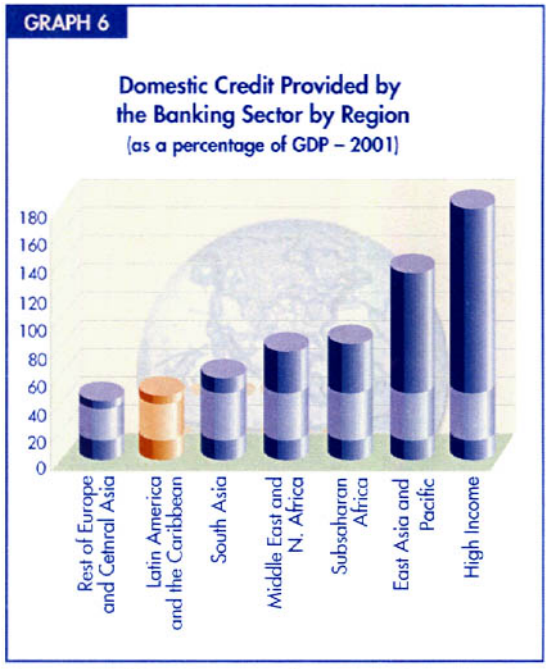
has a key role to play in expanding provision of financial services to population with low income.

Fourth is inadequate *physical infrastructure.* This is a further constraint on generating new investment, raising productivity especially among low-income producers, and achieving growth in many countries in the region. An index that combines indicators of coverage and quality for telecommunications services, electricity, ports and roads shows that ten Latin American countries (out of a total of 21 for which there is information) rank below world standards for their levels of income. Although electricity coverage averages 85 percent, it is not uniform across all countries. While in some it exceeds 95 percent, it fails to reach 70 percent in 7 countries. Similarly, only 27 percent of the region's roads have asphalt surfaces, compared to 92 percent in high-income countries and 51 percent in medium-income ones. The lack of infrastructure is particularly marked among low-income populations in rural areas. For example, access to proper systems of water supply reaches 94 percent of the population in urban areas, whereas in rural areas it is only 65 percent.

The lessons learned in the area of infrastructure services show that neither total deregulation and privatization nor the complete dependence on the public sector can remove the obstacles to both coverage and quality of such services. Improved provision requires measures to modernize the State, action to improve the regulatory framework and the system of incentives to expand the role of the private sector, and in some cases cooperative efforts of a different sort (for example with social organizations to provide water services in small communities or between countries so as to improve road or electricity infrastructure).

In terms of access to *science and technology*, levels of investment in the region are insufficient in generating, assimilating and disseminating technology. For example, the number of scientists and research and development (R&D) engineers per million inhabitants is only 287 in the region, compared with 3,281 in high-income and 778 in medium-income countries. Investment in science and technology as a percentage of GDP in Latin America and the Caribbean is five times lower than in developed countries. The low levels of investment affect competitiveness and limit the extent to which science and technology can help move forward the agenda for economic and social inclusion.

GRAPH 6



Source: *World Development Indicators 2003.*

Fifth are the low levels of human capital (education and health) and social capital, which have become an obstacle to growth in many countries. They limit the potential to increase productivity and, in most countries of the region, are the key determinant of whether or not people fall into poverty.

Education indicators in Latin America and the Caribbean reveal a rhythm of progress that is much slower than in other world regions, as well as serious deficiencies in terms of quality.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

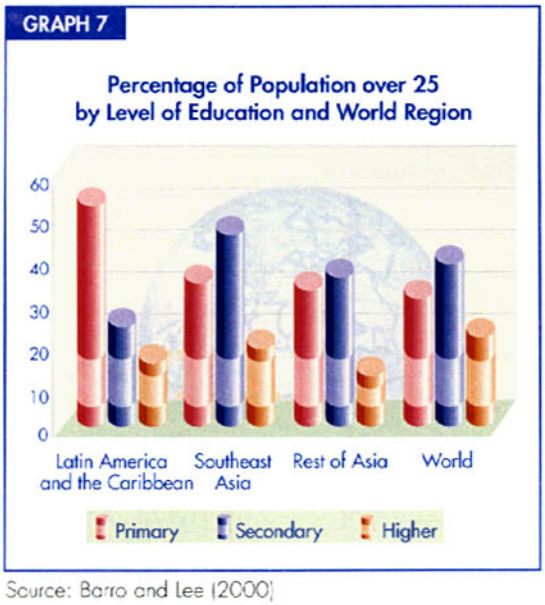
In the 1960s, Latin Americans of over 25 years of age had an average of 3.2 years of education. In the 1990s, the average rose to 5 years. Meanwhile in Southeast Asia, schooling went from 4.3 to 7.2 years, in the countries of the Middle East from 2 to 4.6 years, and in East European countries from 6 to 8.7 years. Only in Africa has educational progress been slower than in Latin America and the Caribbean. The problem of the region resides not in the initial access to the education system, but rather in the low levels of permanence in the system of middle and low-income children. Consequently, most countries in the region have termination rates for secondary education that are lower than would normally correspond to their income levels (graph 7 shows the low concentration of persons with post-primary studies in Latin America and the Caribbean). Indicators of educational performance and quality are also deficient in most countries of the region. For instance, recent estimates indicate that in a group of countries, around 0.7 percent of GDP is lost each year as a result of school repetition. The correlation between repetition and drop-out rates is positive and direct, and often repetition is only a precursor to dropping out. Repetition of a grade increases the chances of dropping-out of school altogether by between 40 and 50 percent. Repetition of a grade for a second time increases the probability to 90 percent. So, once a child repeats a grade, the chances of him or her not progressing increases. Lack of education is closely tied to poverty. The incidence of poverty in households headed by persons who only completed the primary level (41.3 percent) is more than eight times greater than in those headed by persons with higher education (5.1 percent).

Although the deficiencies in health are less widespread than in education, a common feature in the majority of countries in the region is the high level of inequality in nutrition levels, illness, and mortality between low and high-income groups. This is an important constraint to improved standards of living and to the productive incorporation of the poorest sectors of society.

Added to the low levels of human capital in the region is the scant use made of and limited efforts to galvanize social consensus and develop social capital, especially in combating social problems and exclusion (e.g. of indigenous groups, afro-descendents and women). This is a disincentive to investment and helps perpetuate conditions of disadvantage and marginalization.

Lessons learned from these experiences show that social development, brought about by investing in human capital as well as building and profiting from social capital, is not just a goal for equity but also a necessary condition for achieving sustainable economic growth in the region. Social development provides the basis for improving labor productivity by helping to form and maintain human capital. Furthermore, it contributes to reducing inequalities in income and in access to the benefits of development. It also prevents the proliferation of social problems like violence and exclusion, which are factors that help generate an unfavorable climate for investment and productive activity and make it more difficult to tap the full potential of human capital.

GRAPH 7



Source: Barro and Lee (2000)

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Sixth is an *adverse international condition* and limited progress in making full use of the opportunities offered by *regional integration*. This has affected the region's potential to accelerate growth and reduce poverty during the past decade.

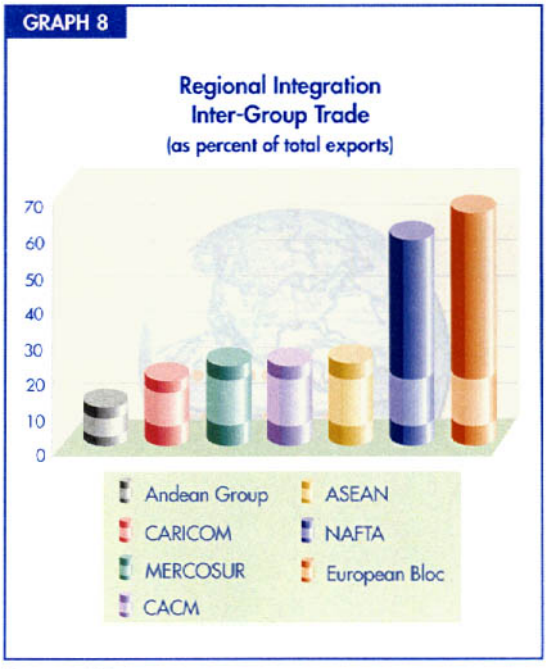
The region's terms of trade deteriorated by 7.6 percent over the course of the 1990s, and were subject to great instability, especially in the case of exports of agricultural goods and minerals. Export income has been affected not only by price instability, but also by the severe market distortions that exist in the international markets and that arise from the large agricultural subsidies offered by developed countries to agriculture and by the restrictions that they place on imports of goods from developing countries.

Access to international financial resources has also been unstable and limited. During the 1990s, net capital inflows fluctuated between US$17 and US$87 billion a year, with a particularly pronounced fall in the wake of the 1998 Russian crisis. In the years that followed this crisis, net capital inflows have been 43 percent below the peak reached in 1998, and direct private investment has been practically the only source of net finance. The experience of the last decade shows that international integration has had a mixed effect on financial markets. The lesson that can be drawn from the international experiences is that capital account liberalization has helped attract capital and reduce its cost, but at the expense of increased volatility. In particular, liberalization has not helped those countries that lacked policies and institutions to avoid pro-cyclical fiscal policies and excessive risk-taking on the part of the financial system.

Another lesson learned is that different integration processes do not necessarily follow the same sequence and that these require political commitment and sustained leadership at the highest level. Similarly, the expansion of trade and regional integration can be blocked by insufficient regional infrastructure to connect national markets and support increased flows of goods and services. Currently, regional trade agreements cover around 20 percent of total exports when compared with other regions where coverage exceeds 60 percent (see graph 8).

Seventh, certain productive practices in many Latin American countries, as well as the precarious nature of production methods and living conditions among poor people, have led to the *unrestricted use and overexploitation of natural capital* in all its forms. This imposes unnecessary costs on society and undermines the basis for economic development for future generations. If not dealt with appropriately, the region's major environmental problems will become a formidable obstacle to achieving higher competitiveness and sustainable economic growth, and will lead to deepening problems of marginality and poverty. Recent studies of the real savings rate in national accounts (which explicitly includes the exhaustion of natural resources and the environmental damage arising from pollution) show that these are lower for Latin

GRAPH 8



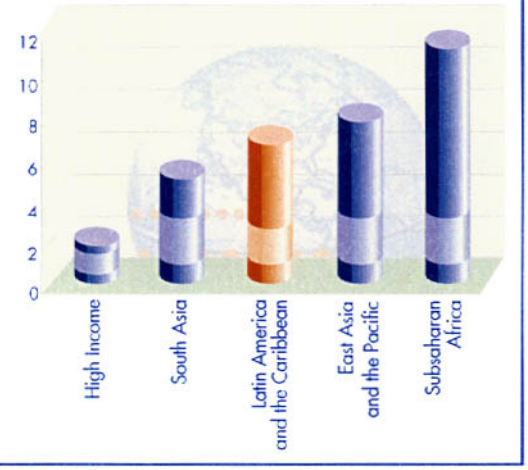
Source: IDB

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

America than for all other regions of the world, except Africa. Four countries in the region have net savings rates that are negative, and a number of others have very low rates, indicating the serious economic impact of the depreciation of natural capital. Graph 9 shows consumption rates for natural capital in the region compared with other selected regions. Clearly, despite some progress, natural capital consumption rates in Latin America and the Caribbean remain nearly four times those of high-income countries. One of the most important lessons with respect to managing natural capital is the need to recognize that the nub of the problem lies in the lack of effective incentives for environmental management and the administration of natural resources. Consequently, environmental problems are encouraged partly by market failures such as externalities and inadequate property rights. They arise also from economic policy, especially subsidies that distort market signals and favor the overexploitation of natural resources, causing environmental degradation.

GRAPH 9

Natural Capital Consumption[1], Latin America and the Caribbean and Other Regions
(Percentage of GDP, circa 2001)



[1] Defined as the consumption of nonrenewable energy and minerals, the net destruction of forests, and damage created by carbon dioxide emissions and particles.
Source: *World Development Indicators 2003.*

It is clear that the region needs to make a major effort to increase the *development effectiveness* of its interventions to overcome the deficiencies described above. Systems to follow up and to evaluate programs in different key development areas leave much to be desired in many countries. These are frequently affected by the orchestration of inefficient programs, lack of coordination and division of responsibilities, fragmentation, and budgetary problems. The region also requires a renewed commitment to development. Countries have adopted the Millennium Development Goals (MDGs) at various summit meetings, like the Quebec Summit of the Americas in 2001, the Monterrey Financing for Development Summit, and the Johannesburg Sustainable Development Summit in 2002. This commitment needs to take concrete shape in the form of significant efforts toward reform, implementation of relevant programs, and allocation of resources in order for targets to be met.

In part, poor economic performance and insufficient social progress are due to the fact that some reforms and programs were only partially implemented, without sufficient institutional support, in difficult international conditions, and with insufficient attention to objectives of equity, good governance and transparency and to the importance of being guided by result-based approaches.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

THE NEW STRATEGIES AND THE IDB'S RENEWED COMMITMENT TO SUSTAINABLE AND EQUITABLE DEVELOPMENT



The IDB's founding countries established as the institution's prime purpose the promotion of economic and social development, individual and collective, of the region's member countries, helping them to: (i) create and maintain an economic policy and investment climate conducive to solid economic growth, and (ii) achieve higher levels of human development for the whole population, including historically excluded groups.

The current challenges facing the region include as key points the reduction of poverty and the promotion of social equity, and the achievement of a vigorous and sustainable economic growth. These two objectives are compatible, complementary and interrelated. They are also essential for democratic development. Economic growth provides the flow of resources required to generate employment and income, as well as for financing development programs that cater to social needs. Without dynamic and vigorous economic growth, it is difficult to resolve social problems. At the same time, it is important to bear in mind that without policies specially targeted at the poor and actions to encourage inclusion, the full commitment to social justice will be absent, the efficiency of resource allocation will be limited, and the possible increases in productivity will be constrained. Indeed, exclusion has been a source of chronic injustice and has deprived societies of an enormous productive capacity. Therefore, actions targeted towards the poor not only contribute to the advance of democracy and to social justice, but also to increase competitiveness and to attain more vigorous economic growth.

In view of these objectives and given the diagnosis offered in the previous section, the Bank produced the document *Revision of Sector Strategies, Policies and Operational Guidelines (Revisión de las Estrategias Sectoriales, Políticas y Lineamientos Operativos*, GN-2077-15) with the aim of enhancing the efficiency of the Bank's assistance to countries in overcoming obstacles to sustainable and equitable development and of responding to its institutional strategy in the sense of revising and updating the strategies and policies that articulate the Bank's work in support of development. With this in mind, and in accordance with the Bank's mandates and the challenges facing the region, support for countries is centered around two overarching or fundamental objectives: *Sustainable Economic Growth, and Poverty Reduction and Promotion of Social Equity*.

In line with this document, the Bank has prepared a new set of strategies, presented in this volume, for the two overarching objectives established (*Sustainable Economic Growth* and *Poverty Reduction and Promotion of Social Equity*) and for each of the four priority areas highlighted in the Institutional Strategy (*Competitiveness, Social Development, Regional Integration,* and *Modernization of the State*). These four constitute areas of comparative advantage for the Bank in providing help to countries in progressing towards achieving the two overarching objectives. The four priority areas were defined, among other things, in view of the current challenges; the Bank's presence in the region; its experience in working in spheres that require capacity for diagnosis and dialogue; actions that require persistence over time; programs that depend

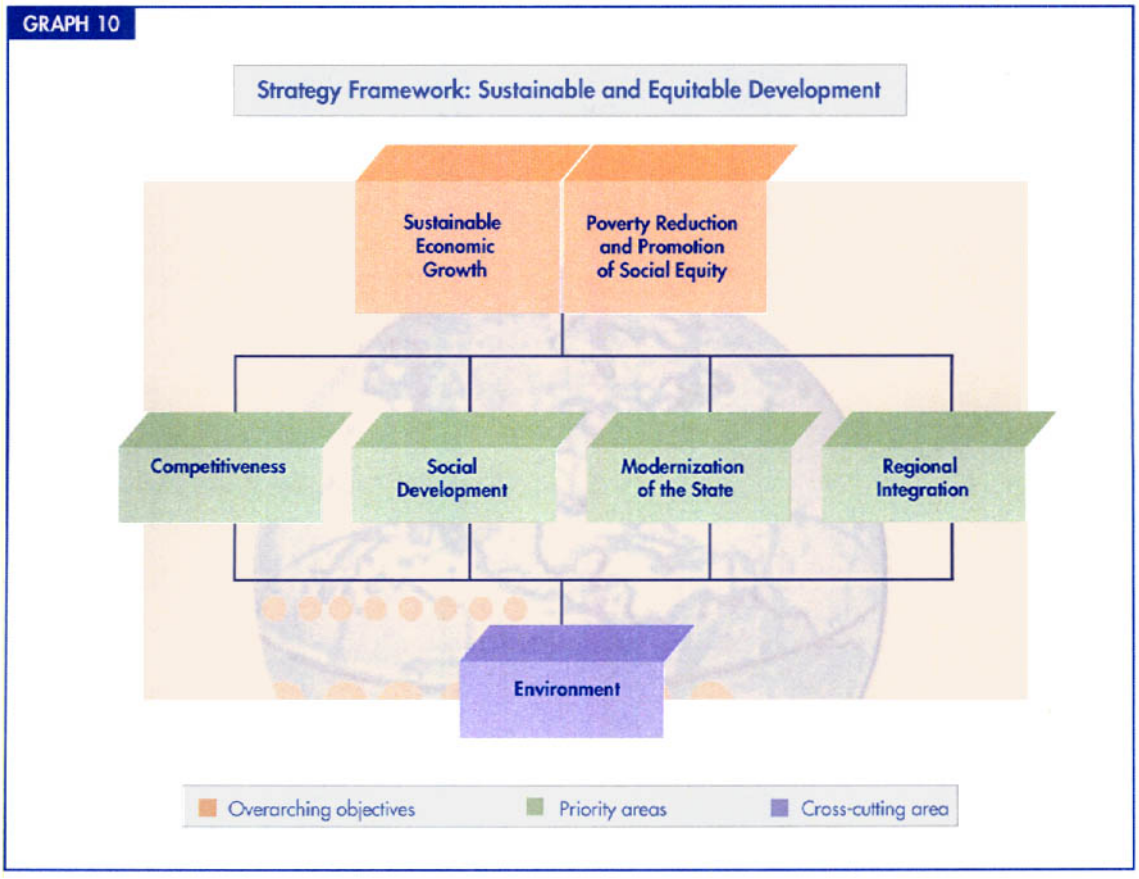
Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

on developing consensus; reforms to policies and institutions; and actions that demand technical and financial assistance. The strategies take on board the cross-cutting nature of the environmental dimension, which is developed in a new Environment Strategy that aims to adequately internalize environmental sustainability (see graph 10).

The *Sustainable Economic Growth Strategy* sets out lines of action to raise levels of growth for investment, income and per capita GDP that would lead to improved living standards, to poverty reduction (since growth is a necessary condition for reducing poverty), and to the preservation or enhancement of the natural resource base. The *Poverty Reduction and Promotion of Social Equity Strategy,* for its part, sets out targeted lines of action to push ahead as fast as possible with reducing poverty and promoting social equity. Both strategies are complementary, compatible and define a general framework for the activities of the Bank. At the same time, the sector strategies for *Competitiveness, Social Development, Modernization of the State, Regional Integration,* and *Environment* take the elements contained in the two overarching strategies and develop them in more detail, being fully consisted with them. Indeed, the latter operationalize the elements contained in the two overarching strategies (which provide the general framework) conforming a set of seven documents which provide a comprehensive and internally consistent package.

The strategies provide a concerted and up-to-date base to guide the Bank's activities in the countries of the region, in ways that respond to their needs and demands, and optimize the Bank's contribution to the

GRAPH 10



Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

process of development. They provide a basis for orienting Bank staff, the governments of member countries, executing agencies and civil society in general on how the Bank seeks to fulfill its institutional agenda. The preparation of these strategies in itself constitutes a valuable exercise in generating consensus in the areas mentioned.

Together, the seven sector strategies developed (2+4+1; see graph 10) set out a comprehensive and renewed package of actions for Bank support to countries, with a view to achieving the reduction of poverty and a process of economic growth with greater equity and preservation of natural capital, improving living conditions for the inhabitants of the region and explicitly attending to the needs of the poor. This is done in the framework of reinforcing the modernization of the State to improve democratic governance, competitiveness in the context of globalization, social well-being with emphasis on inclusion and social cohesion, integration in the light of the new regionalism, and the internalization of environmental sustainability. In what follows, the contents of the new sector strategies contained in this volume are briefly described.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



GENERAL OVERVIEW OF THE NEW SECTOR STRATEGIES

The IDB's new package of strategies advances lines of action to guide the Bank's activities in support of borrowing countries. These are designed to tackle the main constraints on sustainable economic growth and poverty reduction described in the introductory section. Each strategy document contains a description of objectives, diagnosis, lessons learned, priority areas for Bank action, instruments and actions for implementation and monitoring, and indicators to measure development effectiveness.

THE STRATEGY FOR SUSTAINABLE ECONOMIC GROWTH

The *Strategy for Sustainable Economic Growth* offers a multi-dimensional approach and sets out ambits for raising economic growth in the region. The proposed framework of action starts from the recognition that macroeconomic stability helps to improve the context for sustained private investment and gives greater budgetary certainty to public investment. Similarly, it suggests that the quality of institutions, the stability of broadly-based financial systems, adequate infrastructure, and the quality of human capital are all factors that encourage investment and the productivity of existing assets, whether public or private. Furthermore, it suggests that regional integration and a good economic positioning in the context of globalization, strengthen investment and open up new market and growth opportunities. For these reasons, the actions that the Bank proposes to develop respond to the following priorities:

The strategy acknowledges the importance of strengthening the foundations of macroeconomic stability, which requires *pertinent policies* that create sound economic underpinning and a stable environment for growth. These policies are grounded on the fiscal, financial and external sustainability of the economy. To this end, the strategy points out that the Bank will support actions to strengthen fiscal systems, modernize budgetary institutions, strengthen fiscal institutions at the sub national level, and provide access to liquidity at times when external resources are scarce. These are actions in which the Bank's role would complement that of other international institutions.

Furthermore, the strategy takes into consideration the various factors or inputs needed for sustainable economic growth (financial capital, human resources, infrastructure, institutions, natural capital, etc.) and focuses the Bank's attention identifying fundamental activities in each of the four priority areas (competitiveness, modernization of the State, social development and regional integration).

With regard to *competitiveness,* the central objective of the Bank's involvement will be to help improve the institutional and economic climate for the development of the private sector's productive activities in a context of economic, social and environmental sustainability. The Bank considers that its main contribution in this field should be to concentrate on easing access and on improving supply to key productive resources. These include capital and financial resources, improving the efficiency of financial intermediation, regulation and supervision and the

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

development of capital markets; human resources through training, labor legislation and intermediation; infrastructure services (like energy, water, transport, and telecommunications) promoting efficiency, modernization and the widening of both coverage and quality; development, dissemination and application of new technologies, especially information technology; and the promotion of actions for the conservation of natural resources, drawing attention to environmental criteria in so far as productive activities are concerned.

The Bank will support the definition of national competitiveness strategies in its borrowing countries through dialogue processes that enable the identification and implementation of priority actions in an environment of cooperation between government, the private sector, workers and key social actors. During the 1990s, many economic reforms were implemented (e.g. reform of public enterprises, financial sector and pensions reform, etc.) which brought about substantial structural changes. These reforms need to be analyzed, consolidated and complemented so as to enhance competitiveness and obtain higher levels of sustainable growth.

In order to improve the growth possibilities of the region, it is necessary to continue making progress in the *modernization of the State*. A modern State, based on a solid democracy and active citizen participation, is indispensable in ensuring an appropriate relationship between the State and the market, guaranteeing the incentives and conditions on which sustainable growth depends. Consequently, in this area the growth strategy identifies the following priority activities for Bank support: consolidation of the democratic system through the modernization and strengthening of representative institutions (e.g. legislatures), the efficiency in decentralization processes and the promotion of democratic values; strengthening of the rule of law through the independence of the judiciary, modernization of the administration of justice, existence of alternative conflict resolution methods, updating of legislation (mercantile, fiscal, financial and bankruptcy), and programs of public security to support an adequate investment climate; reinforcing institutions that promote competition and simplifying instances that register, control and supervise private activity so as to avoid redundant procedures that are a disincentive to productive activity; modernization of public management, helping to develop policy formulation capacities and the establishment of results-based systems of control and evaluation, and professionalization of the public sector through the establishment of a civil service; and support for environmental governance as one of the guiding principles compatible with sustainable growth. The Bank will support the carrying out of institutional diagnoses at the national level to guide the specific definition of programs.

Social development is required not only to reduce poverty but also to promote economic growth. In this area, the priorities are to accelerate progress, broaden access and improve the quality of education, healthcare and housing, and to promote coexistence based on mutual respect as means to build up social capital. Consequently, the Bank will collaborate with borrowing countries in the revision, consolidation and financing of reforms in education, health and housing; in making optimum use of human resources over the life cycle through the promotion, for example, of a smooth transition between school and work, and reforms to pensions systems; and in supporting mechanisms for the accumulation of social capital and for preventing social conflict and violence. In all of these activities, the Bank will seek to promote policies and programs that connote a good mix between promotion, protection and prevention initiatives, seeking a balance between short-term responses and longer-term reforms and investments.

Regional integration constitutes a fundamental element of structural reforms and is

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

an essential condition for enhancing the possibilities for sustainable growth. On the one hand, it combines with and reinforces unilateral and multilateral opening processes. On the other, it provides guaranteed and regulated access to regional markets of greater size than domestic ones. These promote economies of scale, greater competition and specialization, increased productivity, export experience with diversification, attraction of domestic and foreign investment, more complete markets for capital, labor and technology, and functional cooperation in key areas such as infrastructure.

In supporting regional integration, the Bank's priority actions are geared to the consolidation of regional markets, giving priority to evaluating the costs and benefits of integration options; the opening up of extra-regional markets; the elimination of tariff and non-tariff barriers for goods and services, and the promotion of development policies that support dynamic transformation in productive activities; the development of regional infrastructure, promoting or mobilizing financial and technical assistance for national infrastructure projects that foster integration (including feasibility studies, and social and environmental project impact evaluations), modernizing regulatory frameworks, and promoting the integrated development of frontier regions; institutional strengthening to establish the necessary rules and bodies for integration agreements to be viable and socially and economically advantageous; and cooperation regarding the creation of regional public goods in spheres that encourage economic activity and make use of externalities, such as establishing regional codes and harmonizing financial regulation and supervision.

Insofar as the different policies and actions described are implemented, they will create an improved economic, institutional and social context and a better climate for private investment, economic activity and sustainable economic growth (see chapter on the Strategy for Sustainable Economic Growth).

THE STRATEGY FOR POVERTY REDUCTION AND PROMOTION OF SOCIAL EQUITY

The evidence shows that to reduce poverty consistently it is necessary to achieve high and sustained rates of economic growth, which, as the Strategy for Sustainable Economic Growth highlights, requires a range of different actions. The Strategy for Poverty Reduction and Promotion of Social Equity recognizes the value of these actions, but considers that they are not sufficient, particularly in order to achieve the targets set for poverty reduction. It is important to ensure that growth has a high positive impact on the poor. Basically, the challenge is to achieve and reconcile economic efficiency with equity. Consequently, additional actions are needed to make more substantive progress in attending those currently in a situation of poverty and to eliminate the intergenerational transmission of poverty.

The *Strategy for Poverty Reduction and Promotion of Social Equity* sets out the fundamental actions required in each of the priority areas to reduce poverty and promote social equity. Specifically, the strategy sets out a multi-dimensional vision of poverty with a number of inter-related aspects that affect well-being. These include insufficient income and assets to cover basic needs; inability to avert and confront adverse shocks that impact negatively on income and assets; low human capital development; high exposure to social problems; and inability to participate politically or socially on an equal footing. A comprehensive strategy for poverty reduction requires specific actions in all these fields so as to ensure the economic, social and political inclusion of the poor. In view of this multi-dimensional framework, a significant part of the Bank's activities should continue to be geared directly to poverty reduction and the promotion of equity, in line with the institution's mandates.

The Strategy underlines Bank's support for targeted actions across the four priority areas

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

so as to respond effectively to the diverse causes that produce and reproduce poverty.

In the sphere of *competitiveness,* poverty reduction in Latin America and the Caribbean requires on the one hand improvements to the general situation of competitiveness (dealt with under the Strategy for Sustainable Economic Growth). On the other, it requires confronting those factors that constrain productivity among the poorest workers and small-scale production units. The main areas of action at the general level have already been described. Targeted actions at the poor come under the Strategy for Poverty Reduction and Promotion of Social Equity, and include new initiatives and approaches to increase their level of assets, productive capacities, and access to labor and financial markets, as well as to markets for goods and services.

In particular, the Bank will support programs to improve and widen access of the poor to financial services (short, medium and long-term), expand and improve micro credit services, strengthen the legal and regulatory framework for micro credit (adapting it to the circumstances and risks of the markets where it operates), and promote better access to financial services, including channeling remittances from migrants to micro businesses and small-scale producers. The Bank will also support programs that help establish ownership rights and legal security for land, especially in rural and marginal urban areas, and that reform the legal framework governing the use of land and eliminate legal red tape. Similarly, it will support actions to improve training available to poor workers, modernize the content of courses and adapt programs to the needs of micro business, small-scale enterprises and independent producers, and improve the regulatory framework within the labor market to remove obstacles that prevent access by such workers. The Bank will help improve the dissemination of new technologies, so that small-scale businesses and rural producers gain better access to these and to technical assistance. The Bank will promote programs to provide better access to basic services (energy and water) for low-income populations, taking the necessary steps to ensure their sustainability and the adoption of appropriate technologies (for water, electricity generation and telecommunications) for rural areas where conventional technologies may be inefficient. Finally, support will be given to encouraging local management of basic infrastructure and transport, helping to make the selection, design and maintenance of infrastructure projects culturally adapted in those territories with ethnic populations.

In line with its acknowledged experience and leadership in the social sectors, the Bank has identified new areas and approaches to *social development* with the purpose of promoting equity and widening the range of benefits available to the poor from social spending, confronting the demographic and social challenges faced by the region. They include policies, programs and initiatives that give priority to developing human capital (in education and health) and improving living standards of the poor through housing projects; provision for more effective transitions across the life cycle; help in eliminating social exclusion and strengthening the ability of countries to prevent the proliferation of social ills that impact disproportionately on the poor; and support comprehensive interventions for low-income populations in circumscribed territories. The Bank will give priority to those programs that respond to the challenges set by the Millenium Development Goals and other commitments made at international and regional summit meetings.

Specifically, special attention will be placed on the needs of the poor and excluded through activities in the following areas of social development. With respect to reforms in health and education the activities: will strengthen management of provision systems and improve the effectiveness of spending with equity criteria, will focus on strengthen-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ing financial mechanisms and results-based incentives, and will support coordination between institutions to increase effectiveness, capacity for evaluation, and on-going dialogue with key actors including the poor and excluded. The Bank will continue complementing its support for basic education and health infrastructure in poor areas, and will support innovations to improve the delivery of adequate services in poor communities, as well as targeted human development programs that provide subsidies in return for take-up of these services. Poor and excluded groups may be poorly served by programs that fail to create the necessary links to ensure effective transitions across the various stages of the life cycle. The Bank will support programs that strengthen synergies within the health sector (for example combining programs of reproductive health, pediatric services and measures to combat malnutrition), between health and education (for instance comprehensive programs for family support, early childhood and infancy), between school and work, and between jobs (especially the entry of poor women into the labor force, through, for example training programs, services of labor intermediation and childcare centers). The Bank will support initiatives and programs for social inclusion that ensure that benefits reach excluded groups (whether for reasons of gender, ethnicity, race or disability). These will include measures to strengthen national statistics offices in collecting information on social ills and excluded populations. They will also include the provision of legislation to eliminate social exclusion, and communication campaigns directed against discriminatory practices. The Bank will promote actions to reduce child labor and to attend to the problems of street children, to prevent and deal with domestic violence, and to provide targeted community support against citizen violence. The Bank will support programs in circumscribed territories with a participatory approach. These will include activities of marginal neighborhood improvement and sustainable local development schemes for indigenous and afro-descendant communities that augment their physical and cultural assets and social capital.

Poverty reduction requires the existence of a democratic, effective and efficient State that takes into account the needs and aspirations of the poor, is accountable to them and gives them voice and influence in those institutions that provide governance and access to opportunities. Consequently, the following priorities for Bank action have been selected with regard to *modernization of the State,* each geared toward reducing poverty and promoting equity: support will be given to actions that promote political inclusion for the poor, with emphasis on strengthening the structure and internal mechanisms of parliaments and electoral systems, affording marginal groups voice and participation; support will also be given to programs that give poor people better access to justice, including modernization of judicial procedures so as to reduce the barriers to and costs of access, support for local justices of the peace, and programs that aim to overcome institutional weaknesses prejudicial to the poor. The Bank will also support a comprehensive management approach that: gives priority to the development of the fiscal capacity of the State to pursue pro-poor investments; prioritizes resources for programs of poverty reduction and promotion of social equity; institutionalizes poverty reduction policies; manages efficiently public social expenditure through institutions that have a service-based approach to citizens and are subject to mechanisms of accountability; improves targeting of program beneficiaries; develops capacity for multi-sector coordination within poverty reduction programs (particularly in geographical areas that are most disadvantaged); consults with relevant social actors and enables their participation; decentralizes spending management parallel with institutional strengthening; and applies new technologies to improve the access of the poor

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

to public services. The Bank will also promote capacity building for local environmental management and effective mechanisms to ensure community participation in decision making and in managing natural resources.

With respect to *regional integration,* the Bank will support programs to encourage the consolidation of regional markets, taking into account the economic inclusion of the poor and strengthening the positive impacts of regional trade on low income populations. Programs will place emphasis on: improving access to world markets in areas with comparative advantage and help attract investments that create opportunities for and direct benefits to marginalized groups; enhancing the impact of regional markets in the modernization of the technology being used bearing in mind the abundance of labor in the region; and confronting negative effects on income inequality. The Bank will consider and evaluate national alternatives to support vulnerable populations that may be temporarily affected by integration, with special emphasis on those communities most exposed. The Bank will also continue to support the expansion of regional infrastructure, providing alternative avenues for communication and progress to those living in marginalized areas. The Bank will promote programs for institutional strengthening that include specific components to improve negotiating skills that take into account social equity, balance out and minimize the negative impact of integration on the poor, and strengthen social cohesion through participation by those most disadvantaged. The Bank will support the creation of regional public goods that aim to reduce poverty and inequality, such as the development of depressed border regions and the installation of regional programs on AIDS, distance learning, and the environment.

The actions included in these four major priority areas give special attention to the structural factors associated with poverty and inequality. Additionally, it is necessary to have an adequate social *protection system* because of the recurrence of crises and natural disasters, combined with the inability of poor and vulnerable people to protect themselves from such collective or individual shocks, and which may seriously affect progress towards poverty reduction. This requires actions to prevent, mitigate and deal with the impact of such adverse shocks. The various components of social protection systems need to be set up in advance and have the sufficient flexibility to ensure an automatic, rapid and effective response. Consequently, the Bank will support and promote countercyclical measures and the strengthening of multisector social protection systems in the countries of the region so as to be able to deal with short-term and long-term vulnerability more effectively.

The Strategy for Poverty Reduction and Promotion of Social Equity acknowledges the value of *comprehensive efforts* as essential elements for poverty reduction, and underlines the Bank's support for the development of national strategies in this respect. In each country, the multi-dimensional nature of poverty requires a specific set of policies and programs in the economic, political and social ambits, that attack its multiple causes and manifestations. Furthermore, it is important to ensure that these policies and programs are articulated in coherent ways so as to avoid the dispersion of resources, duplication and even contradictions that may arise.

For this reason, the Bank will give special assistance to those countries of the region who request it to develop and implement *comprehensive national strategies for poverty reduction* within a participative framework. These strategies include detailed analysis of the main factors causing poverty and inequality and the resulting establishment of clearly defined long-term priorities in each country. They also include the selection of feasible and quantifiable objectives for reducing poverty on the basis of the MDGs and other regional commitments and a plan of action for applying these strategies that includes coordination between international financial institutions

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

and donor organizations with regard to financing programs and specific projects, as well as mechanisms for supervising and evaluating their impact. In the case of middle-income countries, support may be provided to comprehensive subnational or sector strategies that target those geographical areas and sectors where the incidence of poverty and its main causes are most acute. Poverty reduction strategies will give emphasis to cross-cutting initiatives in both social and non-social sectors. These need to be environmentally and fiscally sustainable, and take into account gender and ethnic considerations.

All the actions described take into consideration the comparative advantage of Bank support for countries, and help confront the causes of poverty by taking into account the economic opportunities required, the strengthening of institutions, and the human, financial, social and natural capital needed to reduce poverty and inequality. To the extent that these actions involve a more comprehensive approach, they will not only help reduce poverty and inequality but also contribute to faster growth on the basis of a more efficient allocation of resources.

SYNTHESIS OF STRATEGIES FOR ACHIEVING THE TWO FUNDAMENTAL OBJECTIVES

As can be seen from the contents of the strategies for the two overarching objectives, ensuring sustainable economic growth and reducing poverty and inequality, call for harmony and complementarity between the functions of the State, the private sector and civil society. The State should assume a central role in the ordering and functioning of markets in such a way as to facilitate the development of the private sector as the engine of economic modernization. It should assume responsibility for providing basic services for the security and well-being of the population and promote justice and social equity. The private sector should contribute, in a responsible manner, to the creation of employment and the provision of the goods and services that the population requires and for which it has a comparative advantage. For its part, civil society should play an active and participative role as enabler in the process of economic modernization, in public management and in the tasks of inclusive development. The participation of everyone is needed to ensure a degree of social cohesion that leads to sustainable and inclusive development. In these spheres, the IDB can offer substantive assistance.

Together, to promote sustainable economic growth and to reduce both poverty and social inequality, the two overarching strategies highlight, among other aspects, the importance of Bank support for policies and programs to:

- Maintain Macroeconomic Stability, strengthen fiscal sustainability, and improve the business climate;
- Institutionalize Social Policy, design and implement comprehensive national strategies for poverty reduction, and ensure adequate targeting and evaluation of programs, as well as efficient multi-sector social protection systems;
- Develop Human Capital by means of more effective investment in health and education;
- Consolidate and finance Housing reforms;
- Develop Social Capital, promoting citizen participation and social inclusion, and reducing social ills like violence and discrimination;
- Consolidate a Democratic Political System, strengthening representative institutions and achieving the political inclusion of citizens;
- Strengthen the Rule of Law, ensuring the definition of and respect for property rights and access to justice;
- Modernize and professionalize Public Administration and render it more transparent and effective at all levels, enhanc-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ing the State's capacity to respond to development needs and to tackle poverty and inequality;

- Strengthen relations between the State, the Market and Society, including cooperation between the public and private sector to enhance competitiveness;
- Promote the development of the Private Sector and particularly micro, small and medium enterprises.
- Increase savings and improve the supply and access of businesses, workers and producers to Financial Resources;
- Promote efficient and inclusive Labor Markets through training systems, labor legislation and intermediation in order to improve the use of human resources in productive activities;
- In the context of highly competitive markets, improve delivery of Infrastructure services and take advantage of synergies resulting from regional projects;
- Improve the institutional framework and mobilize resources to assimilate and develop New Technologies;
- Promote the strengthening of institutions, normative frameworks and appropriate instruments for environmental management and consolidate Environmental Governance at different levels of government and in different ambits;
- Widen Access to Markets, regional and extra-regional; and
- Promote cooperation in the generation and use of Regional Public Goods.

It is worth noting that these areas of action are further developed in different strategy documents that identify more precisely the key priorities for achieving each objective.

STRATEGIES FOR THE PRIORITY AREAS

The strategies for *Competitiveness, Social Development, Modernization of the State, Regional Integration* and the *Environment,* take up, collectively, the agenda described in the previous section. They take the contents from the two overarching objectives and develop them in more detail in order to make them fully operational. The strategies for the overarching objectives thus provide a general framework and guidelines for the strategies of the priority areas, while the latter documents identify in greater detail the specific actions required in each area and the instruments to be used for achieving the overarching objectives. The framework of the Bank's sector strategies defines priority actions of a general scope to promote development, while also identifying those aspects that require more targeted action to tackle and compensate for the disadvantages facing the poorest sectors. The annex summarizes the areas in which the Bank will act within each of the areas of comparative advantage, with a view to envigorate sustainable economic growth, and reduce poverty and social inequity.

IMPLEMENTATION PLAN

The implementation of the Bank's new package of sector strategies will be carried out taking into account the whole range of instruments and activities at the Bank's disposal. These include (i) financial products (loans and technical cooperations), which have as a basic framework the country strategies that define the Bank's operational program in each country, and the regional strategies that define the Bank's operational program at the subregional level; and (ii) non-financial products (policy dialogues, conferences and seminars, studies and sector diagnoses, operational guidelines, analysis of best practices and lessons learned, etc.), which are defined within the framework of dialogue with each country and the Bank's own needs to undertake strategic activities, research and country support.

The different specific activities for implementing the strategies are included in the document *Integrated Plan for Strategy Im-*

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

plementation (Plan Integrado de Implementación de las Estrategias, GN-2195-3), which looks at activities in the areas of dissemination, elaboration of country strategies; national and regional programming; operational design; execution and monitoring of operations; evaluation of operations and lessons learned; research and analysis; and coordination with other development agencies and donors.

The implementation of the new sector strategies provides the opportunity to capitalize on and disseminate the Bank's accumulated experience on these issues. It also enables the use of approaches that reflect the most recent specialized research, success stories from countries within and outside the region, and approaches, studies and best practices of many organizations, incorporating these progressively into the Bank's operation mechanisms.

Similarly, strategy implementation provides valuable opportunities to link, on the one hand, with the implementation of the guidelines for Country Strategies (which frame the Bank's work with the countries) and, on the other, with the various initiatives that seek to increase the Effectiveness of the Bank's activities in support of the countries of the region, the ability to evaluate its activities and the quality of its portfolio of operations. The combined effect of the approaches that have and will be adopted within this group of issues, all closely related to one another, will be to progressively improve the alignment of the mechanisms, instruments, criteria and skills of the Bank in maximizing its contribution to the development of the countries of the region, bearing in mind the current challenges they face. In this context, a specific function of the seven new strategies is to provide thematic orientation for a renewed sense of the Bank's mission towards its member countries.

It is important to note that the country strategies provide the concrete operational framework for the application of the sector strategies and the institutional commitments that these represent. The country strategies establish the activities for operational programming by identifying, through dialogue, the Bank's priority areas for action in each borrowing country. By establishing the scenarios and goals of the Bank's operational program with each country, the country strategies would reflect how the two overarching objectives and the environmental dimension, as well as the strategies for the four priority areas that may be pertinent, are being applied taking account of the realities, priorities and demands of each country. Equally, the documents for regional programming provide the instrument for incorporating the sector strategies that may apply in identifying and defining the Bank's priorities and activities at the subregional level.

Finally, it is important to note that the purpose of this book is to bring together into a single volume the seven documents that are used for programming processes with the countries and in the design of Bank projects to promote development in the region. These strategies complement the sector policies and operational guidelines whose purpose is normative and which have a specific application. The seven strategy documents that follow were endorsed by the Board of Executive Directors of the Inter-American Development Bank.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ANNEX

Table 1 provides a summary of the overall framework. The two overarching objectives of Sustainable Economic Growth and Poverty Reduction and Promotion of Social Equity provide a global framework that is made operational through the four areas for priority action (Modernization of the State, Competitiveness, Social Development and Regional Integration).

The actions itemized in the first column seek to foster economic growth and together summarize the main points of the Strategy for Sustainable Economic Growth.

In turn, the activities listed in the second column are targeted actions and together constitute the Strategy for Poverty Reduction and Promotion of Social Equity.

With regard to the priority areas, horizontally the Table summarizes the actions within each sector strategy. For example, the rows on modernization of the State coincide with what is dealt with in the Strategy for Modernization of the State, bringing together both the overall actions of general orientation required for economic growth and those targeted on the poor to have more effective poverty alleviation. This set of actions are dealt with more broadly than in the overarching strategies, thereby making them operational.

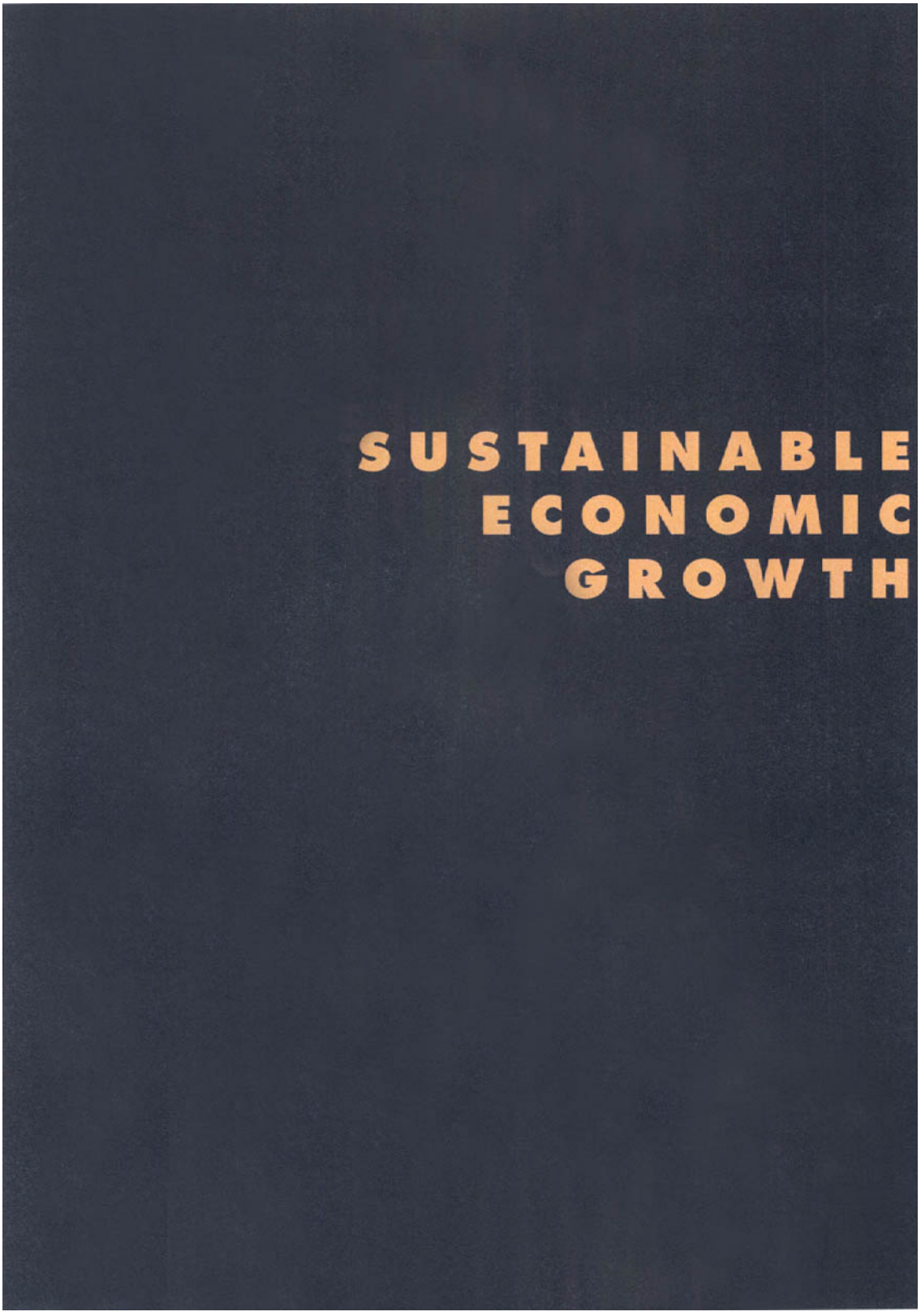
Finally, it is worth noting that both the overarching strategies and the four priority areas deal with the environmental dimension, in recognition of its cross-cutting nature. Indeed, the last line of each priority area includes issues that are described at greater length in the Environment Strategy.

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

Table 1: Overall Outline of the Strategies

	Sustainable Economic Growth	Poverty Reduction and Promotion of Social Equity
	• Macroeconomic stability	• Comprehensive strategies for poverty reduction • Social protection systems
Modernization of The State	• Consolidation of the democratic system.	• Democratic system and political inclusion of the poor.
	• Strengthening of the rule of law.	• Access to justice for the poor.
	• Strengthening of ties between the State, market and society.	• State, market and equity.
	• Modernization of public management.	• Public management for equity.
	• Environmental governance	• Environmental governance at the local level
Competitiveness	• Access to financial resources.	• Property rights and expansion of financial resources for the poor.
	• Improvement and more efficient use of human resources.	• Improvement in employment opportunities for the poor.
	• Improvement in the delivery of infrastructure services.	• Promotion of inclusion through basic infrastructure for the poor.
	• Assimilation and development of new technologies.	• Access to science and technology for the poor.
	• Cooperation between public and private sectors for competitiveness.	• Cooperation between the public and private sectors to increase the competitiveness of the poor.
	• Availability and quality of natural capital	• Productive management of natural resources in marginal communities
Social Development	• Health, education and housing reforms.	• Reduction in inequalities in access to healthcare, education and housing.
	• Development of human capital by means of a life-cycle approach.	• Equal opportunities across stages of the life cycle.
	• Development of social capital.	• Elimination of social exclusion by means of the development of social capital.
	• Promotion of development in local areas.	• Local and territorial levels as the center for poverty reduction.
	• Environment and social development	• Social development, attention to environmental degradation in poor areas
Regional Integration	• Widening of markets.	• Promotion of positive impacts from regional trade on the welfare of the poor.
	• Development of regional infrastructure.	• Investment in infrastructure in less developed areas.
	• Strengthening of institutions that support integration accords.	• Adequate institutions for negotiating and implementing balanced agreements that take on board economic inclusion.
	• Cooperation in regional public goods.	• Promotion of cooperation in regional public goods that benefit the poor.
	• Environment and regional integration	• Environmental dimension in marginalized cross-border areas

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This document was prepared in RES and SDS by Eduardo Lora (RES), with support from Ricardo Quiroga (SDS/ENV) and César Patricio Bouillon (SDS/POV), as part of a team led by Carlos M. Jarque (Manager, SDS). Contributions were received from Walter Arensberg (SDS/ENV), Omar Arias (SDS/POV), José Brakarz (SDS/SOC), Xavier Comas (RE3/SC3), Koldo Echebarría (SDS/SGC), César Falconi (RE3/EN3), Luis Fierro (SDS/SDS), Edmundo Jarquín (SDS/SGC), José Alberto Paz (RE2/FI2), Fernando Quevedo (INT/ITD), Alvaro Ramírez (SDS/MSM), Héctor Salazar (EVP), Robert Vitro (SDS/ICT), Gustavo Yamada (SDS/POV), and Mario N. Yano (RE1/EN1), suggestions from many other members of the Bank's staff and various consultation groups comprised of government representatives, the academic sector, and civil society, at the national and regional levels, and comments received through the Bank's website. Assistance was received from María Lourdes Gallardo, Aura Oradei, and Luis Tejerina (SDS/POV). The authors appreciate all these contributions.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

OBJECTIVE



Sustainable economic growth is an objective reiterated in the Eighth General Increase of Resources and the Institutional Strategy. In fact, the two overarching goals for Bank action are the reduction of poverty and equity promotion and sustainable economic growth. Judging from international experience, these objectives are not in opposition, but rather are complementary and mutually reinforce each other.

Achieving sustainable economic growth is necessary to reduce poverty. Growth provides the flow of resources needed for employment and income generation, and for the financing of programs geared towards poverty alleviation. At the same time, a number of studies have shown that persistent inequality limits a country's growth potential. Accordingly, addressing the levels of inequality in human capital and access to productive assets for the poor will help generate more opportunities for their inclusion in economic activities and will contribute to growth. Therefore, advances in poverty reduction and the promotion of equity are a fundamental development goal. Economic and social development strategies for the region must therefore include growth policies and specific actions for the poorest population, excluded groups, and low-income geographic areas. Clearly, the two objectives of poverty reduction and sustainable economic growth are compatible and renewed efforts are needed to promote growth and to ensure that the benefits of that growth accrue to the poor. While the overarching goals are closely interrelated, complementarity is not automatic, as it depends on the selection and orientation of policy instruments and on the attention given to their sustainability.

The objective of the Sustainable Economic Growth Strategy is to contribute to increase the growth rates of per capita GDP and income of the countries in the region, under conditions that lead to improving the quality of life of the population, alleviating poverty, and preserving or improving the natural resource base. The strategy is consistent with the agreements of the 2002 Johannesburg Summit, that define environmental protection and social and economic development as fundamental to sustainable development.

In the context of the Institutional Strategy, areas of action have been identified in which the Bank has a comparative advantage and through which this objective can be achieved: Social Development, Modernization of the State, Competitiveness, and Regional Integration. In addition, the importance of considering the environmental dimension a core element of the multiple efforts is recognized. This strategy therefore has a multidimensional focus and establishes the relationships between these areas and the general goal of sustainable economic growth. The term sustainable in this strategy is based on the concept of environmental sustainability, but also implies the broader framework of sustainability of economic and social development processes.

This strategy proposes priority actions to guide the activities and services of the Bank in this area, on the basis of a diagnostic assessment and lessons learned from policies and programs. It is expected that the Bank's financial and non-financial activities will effective-

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

ly help the countries make progress towards the objective of sustainable economic growth. In addition, the objective of the Poverty Reduction Strategy is to promote greater progress towards poverty reduction through targeted actions that address the causes of poverty and that achieve inclusion and greater social equity.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



The growth recorded in Latin America and the Caribbean over the last five decades has been disappointing. With the sole exception of Africa, all the other regions in the world achieved better results. Consequently, the relative position of Latin America in terms of per capita income went from second in the 1950s to fifth presently, coming in behind Southeast Asia, the Middle East, and Eastern Europe, and ahead only of the rest of Asia and Africa.

Although per capita income growth recovered in the 1990s, following the "lost decade" of the 1980s, the average annual rate was only 1.5 percent. If this rate does not improve, it will take almost a century to achieve the current per capita income levels of developed countries. In addition, Latin American growth rates need to be environmentally sustainable since, until now, growth has been attained in part at the expense of environmental quality and the unsustainable consumption of natural resources.

One of the reasons for the reduced growth rates during the last decade was the disappointing performance of productivity growth in the region. While the stock of physical capital grew at an annual average of 2.6 percent and 3.7 percent during the eighties and the nineties, respectively; overall factor productivity decreased at an annual average rate of 2.65 percent and 0,62 percent during the same periods. These data contrast with the results in developed countries, Eastern Europe and the rest of Asia where productivity increased at an annual average rate of 0.56 percent, 0.82 percent y 0.69 percent respectively, during the last decade.

Economic growth in the region over the last decade had limited impact on the reduction of poverty and social inequity because of its insufficient level, its high volatility, and its limited capacity to generate good jobs and increase the income of less skilled workers. Hence the increase in income inequality observed in various countries. Without a doubt, economic growth needs to recover, speed up, and become less volatile, if greater poverty alleviation is to be achieved. In addition, actions must be taken to ensure that economic growth benefits the poor in an equal or higher degree on a sustainable basis.

A plethora of academic studies have identified the main determinants of productivity, investment, and economic growth. In these studies, an evaluation of growth in Latin America and the Caribbean in relation to other regions shows that the main reasons behind lack of growth over the last decade include: (i) the low quality of public institutions; (ii) inadequate macroeconomic policies; (iii) weak financial systems; (iv) the low quality of physical infrastructure; (v) the low levels of human capital; and (vi) the adverse international climate. It has also been demonstrated that, in many cases, growth has been associated with the unfettered use and overexploitation of natural capital in all its forms, which imposes unnecessary costs on society and compromises the foundations of future generations' economic development. In addition, a series of recent studies shows a dual causality among actions aimed at reducing poverty and growth. As mentioned, on the one hand, average growth is one of the most important factors in reducing poverty and, on the other, actions aimed at reducing poverty

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

can contribute significantly to economic growth. During the 1990s, persistent levels of poverty, inequality, and exclusion of a significant proportion of the population continued to curb the possibilities of recovering and sustaining higher rates of economic growth.

The *public institutions* with the greatest impact on economic growth are those that pave the way for individuals and their businesses to benefit from their productive efforts. This, in turn, contributes to making the beneficiaries choose to invest in education, technology, physical capital, and environmental quality. This phenomenon demands adequate protection of property rights, respect for the law and contractual commitments, and the absence of corruption. Although measuring the quality of institutions is very difficult, most quantitative indicators and studies consistently show that the region has serious problems in terms of respect for the law and the existence of corruption. The most comprehensive summary of the existing indicators shows that 16 of 26 countries in Latin America and the Caribbean fall below the world average in terms of respect for the law, while 18 fall below that average for control of corruption. This is not only due to the fact that the majority of the region's countries have modest per capita incomes since, if per capita income is taken into account, 17 countries in the region have indicators below the expected level in terms of respect for the law, and 20 do in terms of control of corruption.

Inadequate macroeconomic policies are particularly harmful to growth when they jeopardize price stability and cause the level of public spending to be unsustainable or excessive for the size of the economy. Despite the region's progress in terms of the quality of macroeconomic policies, a large number of countries in the region is still affected by these problems. For example, during the 1998–2002 period, four countries had annual inflation rates above 20 percent in one of the years. At the end of 2001, 11 out of 26 countries had public debt levels over 50 percent of GDP. Inasmuch as the ability of the governments to collect taxes is very limited, fiscal sustainability in some of these countries is at risk.

The region's *financial system* requires improved oversight and regulatory systems, and deepening in order to be able to address the demand for resources from micro enterprises and small and medium-sized businesses, and from independent producers, particularly in the rural areas. The strengthening of financial regulation and oversight is essential to ensure the financial system's stability. The authorities in each country must set out guidelines and mechanisms for properly managing the risks assumed by the financial system, thereby protecting the integrity of deposits. While the region as a whole has made significant progress towards attaining—and in some cases exceeding—international standards, several countries are lagging in terms of their prudential practices. It is important to take into account that not all international formulas can be applied in all countries. Recently proposed changes to the Basle Accord, for example, require internal risk evaluation systems that several countries do not have and that may take a while to be developed.

The inadequate *physical infrastructure* can act as a constraint on productivity gains, new investments, and growth. One index that combines indicators on the coverage and quality of telecommunications, electricity, port, and road services shows that 10 Latin American countries (out of a total of 21 for which data is available) fall below world standards for their income levels. Over the last decade, the region made significant progress in the area of telecommunications, with expanded coverage and significant quality improvements in many countries. In 11 countries, however, telephone coverage is still below 10 telephone lines per 100 inhabitants. The improvement in telecommunications has paved the way for the adoption of information technologies, which have advanced, on aver-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

age, at a faster rate in Latin America than in other regions in the developing world and faster than international standards for the income of the countries, although wide disparities in terms of access persist. At over 85 percent, on average, electricity coverage is significantly broader than that of telecommunications. But this level of coverage is not uniform for all the countries. In some countries, the coverage exceeds 95 percent; yet there are seven countries in which it falls below 70 percent. Of more concern is the fragility of the reforms under way, the lack of interest among private entrepreneurs in investing in the expansion of capacity required, under conditions of regulatory and economic uncertainty, and the inability of State-owned enterprises and some private companies to collect payments and address losses from inadequate billing and distribution. For example, 17 countries (of the 20 for which data is available) show distribution losses of over 10 percent due to technical reasons or lack of billing. In some countries, the supply of electricity is subject to frequent interruptions. Roads and ports present serious deficiencies that significantly affect the cost of transportation, undermining international market competitiveness. Aside from the fact that road density is very low in most countries, especially in rural and marginal areas, less than half the roads are paved in nine countries in the region (out of a total of 10 for which data is available). Port efficiency indicators rank Latin America almost in last place, ahead of only the low-income countries of Asia, and Africa.

The low levels of *education and human capital* have become an obstacle to growth in many countries, because they are limiting the possibilities of technological modernization and increases in productivity, particularly for the poorest. Education indicators in Latin America and the Caribbean show a much slower rate of progress than in other regions of the world, in addition to serious quality lags. In the 1960s, Latin Americans above the age of 25 had 3.2 years of schooling. This average rose to 5 years in the 1990s. In the meantime, the countries of Southeast Asia went from 4.3 years to 7.2 years, the countries of the Middle East from 2 to 4.6 years, and the countries of Eastern Europe from 6 to 8.7 years. Only in Africa has educational progress been slower than in Latin America. In many countries, educational progress has been practically stagnant for younger generations. The problem in Latin America and the Caribbean is not initial access to the education system, but rather school retention in the system for the low and middle classes. As a result, most countries in the region have secondary completion rates below what would be expected at their income levels. Although deficiencies in the area of health are less generalized than those in the education sector, a trait common to most of the countries in the region is the inequality in nutrition, disease, and mortality levels between low-income and high-income groups, which constitutes a very important constraint in terms of the productive inclusion of society's poorest groups.

An adverse *international scenario* has affected Latin America. Combined with the previous deficiencies, the external instability has resulted in high macroeconomic volatility, which has severely limited economic growth. During the 1990s, the region's terms of trade fell by 7.6 percent and were subject to great instability, which was particularly pronounced for agricultural products such as coffee, sugar, and banana, for petroleum, and for the most important mining exports, such as copper and coal. Export's revenue has been affected not only by the instability in prices, but also by severe market distortions in international markets due to substantial subsidies granted by developed countries to agriculture production and by restrictions imposed to imports originated in developing countries. Access to international financing has also been very unstable and limited. During the 1990s, net capital inflows fluctuated between

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

US$17 billion and US$87 billion per year, with a particularly significant drop after the Russian crisis of 1998. In the years following that crisis, net capital flows have remained on average at 43 percent below the 1998 peak and private direct investment has been practically the only source of net financing. Although international credit markets have evaluated the individual country risk better since that crisis, sudden changes in country risk perception and incidents of contagion have not disappeared.

The trend in economic growth in Latin America and the Caribbean has also been at the expense of environmental sustainability. The region's natural capital and *environmental quality* in general have been secondary considerations in short-term economic and political decision-making. Environmental degradation and natural capital depreciation in all its forms are reflected in the population's health, productivity and income loss in key sectors, and quality of life in general. Recent World Bank studies on genuine savings rates in national accounts, which explicitly incorporate the depletion of natural resources and the environmental damage caused by pollution, show lower rates for Latin America than for other world regions, with the exception of Africa. Four countries in the region have negative net savings ratios and another four are at comparatively very low levels, demonstrating the serious economic impact of natural capital depreciation.

If the region's considerable environmental problems are not addressed and dealt with adequately, they could become a formidable obstacle to achieving the goals of competitiveness and sustainable economic growth and could exacerbate the factors of marginality and poverty. The most important challenges facing the region include: improving coverage and access to clean drinking water; reducing urban pollution levels (five cities in the region are among the 20 most polluted cities in the world); controlling natural resource base degradation (soil, water, forests, biodiversity), and achieving environmental goods and services productive sustainability (14 countries in the region are among the 40 countries with the highest rates of deforestation); using marine and coastal resources in a sustainable way; reducing physical vulnerability to natural disasters; and preparing the region to face global environmental challenges. Although over the last decade all countries have established institutions, laws, and policies to address environmental problems, the state of institutional, legal, and regulatory development is still weak in most of them at present. Efficient management instruments and a framework of general governance to take on the environmental dimension of development comprehensively and across the board are lacking.

Recently, the Heads of State of the region undertook to achieve the Millennium Development Goals (MDGs), which are closely tied to the objective of resuming high sustainable economic growth rates. While there is no specific goal for economic growth in the MDGs, there is an important dual causality between the objectives of poverty reduction, investment in human capital and environmental sustainability, and sustainable economic growth.

- *Halve, between 1990 and 2015, the proportion of people living in extreme poverty.* This goal requires actions to increase the region's average per capita growth rate and reduce income distribution inequities. To achieve the target indicated, the average per capita growth rate in the region needs to be increased from the annual 1.5 percent registered over the last decade to at least 4.0 percent per year, assuming that no significant changes in income distribution occur. In the countries with a high incidence of poverty, the effort to promote growth needs to be even greater. Targeted actions aimed at raising the productivity of the poor will help accelerate economic growth in the region.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

- *Invest in human capital.* Achieving the goals of universalizing primary education by 2015 and reducing infant and maternal mortality and the incidence of endemic diseases in the region implies important investments in human capital that will contribute to improving labor productivity and promoting economic growth. The generation of economic opportunities and income stemming from economic growth will allow workers to invest in the human capital of their families.
- *Ensure environmental sustainability.* The MDGs seek to integrate the principles of sustainable development into country policies and programs and to reverse the process of environmental resource degradation. The indicators include: (i) proportion of land area covered by forest; (ii) land area protected to maintain biodiversity; (iii) per capita energy use; (iv) carbon dioxide emission levels; (v) proportion of the population with access to safe water and sanitation services; and (vi) access to secure property/land tenure. In addition, the framework of agreements and principles stemming from the World Summit on Sustainable Development in Johannesburg buttress commitments and initiatives to achieve significant improvements in the areas of water, renewable energy, quality of life in the cities; fisheries, climate, biodiversity, use of chemicals, and trade, among others.

It is worth noting that the MDGs carry important implications in terms of financing and access to international financial resources. Aspects such as access to international markets and external debt sustainability are also key elements that are part of the set of actions that must be taken into account to attain sustainable economic growth and to achieve the MDGs.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



LESSONS LEARNED

Valuable lessons on the difficulties involved in achieving sustainable economic growth have been set out in numerous studies and shown through several decades of activity by the Bank and other international financial institutions in developing countries. The most general and most important lesson is that there is no recipe that guarantees growth. Thus, the emphasis on maintaining adequate savings and investment rates in the 1950s and 1960s, and on opening economies in the following two decades, proved insufficient as a strategic guide for development policies. Without ignoring the possible significance of these variables, their relationship to growth is complex and is influenced by many other factors. Similarly, although the principles expounded by the Washington Consensus in the 1990s may have contributed to establishing macroeconomic equilibrium and making progress on required reforms, they necessarily constituted an incomplete list. Their effectiveness depended upon a variety of factors.

Economic growth is the result of the accumulation of factors and increases in productivity. The significant differences in rates of growth among world countries are due much more to differences in productivity behavior than to factor accumulation. But both growth sources tend to be affected by common variables and, in particular, by society's capacity to assimilate and generate knowledge and technologies and apply them to productive activities, and by the opportunities that enterprises and individuals have to gain ownership of the results of their own efforts. Growth is achieved by increasing the productivity of existing investments or by making larger investments, or a combination of both. It is therefore important to improve the overall climate in which these investments are made and developed. The latest studies stress the role of various aspects that simultaneously affect both factor productivity and its accumulation.

There are many lessons on barriers that can hamper investment and sustainable growth. Even when the basic conditions for macroeconomic management are in place and the main markets of goods and services are operating adequately, sustainable growth can be slowed down by factors as varied as the absence of institutional and political mechanisms to implement reforms, secure fiscal equilibrium and macroeconomic stability and to respond adequately to crises, or explicitly allocate the social costs of the use of natural resources and environmental depletion. Growth may also be hindered by the absence of coordination mechanisms that help take advantage of competitive opportunities requiring joint action by many economic agents. Or it can be held back by distributional conflicts and blocking strategies among ethnic, social, or political groups, making it difficult to invest in public goods essential to development (such as security, infrastructure, or environmental preservation). In addition, high levels of poverty, inequality, and social exclusion can limit the economy's growth potential to the extent that they curb physical and human capital accumulation, reduce returns on investments, provoke social and distributional conflicts, and hamper the adoption of appropriate policies for the management of external shocks. These and other factors have led development analysts and

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

experts to recognize that, although the importance of some general factors may be identified (such as those indicated in the previous section), it is a mistake to expect that a change in one or a few variables could fundamentally alter the possibilities for investment and growth.

Although the region's countries have done important advances in macroeconomic handling in the last years, the performance of the economies during the past decade shows the importance that *budgetary arrangements and fiscal management* have, both at national and sub national levels, for achieving of *macroeconomic stability*. Solid budgetary arrangements and fiscal management produce better fiscal results, such as smaller deficits and national debt. In addition, suitable budget institutions can generate scenarios of greater certainty, and tie in a narrower way public policy priorities with the programs that are finally carried out. This contributes to growth through several different channels. On the one hand, smaller deficits, and a smaller public debt can reduce the public sector financing cost in a remarkable way that in addition is usually a lower limit for the private sector financing cost. On the other hand, high deficits tend to require drastic adjustments, and in general the investment and maintenance of public infrastructure are usually the first victims of such adjustments. Finally, more transparent budget adjustments are fundamental to improve spending quality, and to adapt public programs to society preferences. This can be important to obtain population support in favor of other necessary reforms needed to make the country more competitive. The presence of untenable fiscal deficits or procyclical tendencies of the fiscal deficit can be used as an alert criteria to analyze if a country has serious deficiencies in its budgetary institutions and in its fiscal handling.

Fiscal handling at the sub-national level is also of vital importance for the macroeconomic stability, especially in the context of the decentralization processes that many of the region countries are currently experiencing. Fiscal strengthening at the sub-national levels is not only desirable for macroeconomic reasons; in addition, it can make space for public policies at the local level, without which strategies, such as those for the support of clusters, cannot be developed. It is certain that the most important taxes can only be collected efficiently at the national level. Nevertheless, real state taxes, business registry taxes, over-rates to fuels and fines, are examples of taxes that can more efficiently be collected by sub-national units.

A lesson that the International Financing Agencies and donor countries should not ignore is that the possibilities of economic growth for the developing world not only depend on the conditions and policies of those countries, but also on the quality of the international environment. The existing distortions and barriers to trade in developed countries, the recurrent volatility of financial flows to emergent countries and the deficiencies and uncertainties relative to the international financial architecture constitute severe limitations for developing countries. Of course, these limitations are more harmful when they are combined with internal deficiencies in macroeconomic management or in the quality of institutions in these countries, but the political and practical possibility to correct these deficiencies is smaller under adverse international contexts.

Given that many conditions for economic growth seem to depend on the quality of *public institutions*, ranging from the possibility of orderly and stable macroeconomic management up to the adequate functioning of markets and the effectiveness of structural reforms to make them more flexible, it is logical to conclude that improving the quality of these institutions is essential and probably the most important factor for sustainable economic growth. There is much less consensus, however, on which public institutions must receive priority and how they can be improved. In this context, public institutions

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

are understood not only as government organizations, but also as any rules and practices (whether formal or informal) governing the way individuals relate to each other and to the State apparatus. Institutional change depends on factors such as local conditions, cultural circumstances, or the presence of leadership, which are not easy to mold or predict.

An additional lesson drawn from international studies is that a country can have institutions of varying quality, and this needs to be taken into account to focus institutional change efforts. Typically, Latin American countries have market regulatory institutions that are comparatively much better than their rule of law and degree of corruption control. International financial institutions nevertheless continue to focus disproportionately on fine-tuning regulation and give little attention to improving the rule of law or battling corruption. International studies have also shown that the importance of each type of institution for growth greatly depends on the country's income level. For example, rules and organizations to protect intellectual property rights can be essential to maintaining technological change in developed countries, but not necessarily to improving the growth rate of poor countries.

Moreover, international experience suggests that unsound institutions can crack in the face of sharp drops in income and significant internal or external shocks, compromising the sustainability of growth over the long term. In this regard, the problems of several countries in the region show that the priority of fiscal equilibrium combined with the idea that institutional reforms could be part of the second and third generations of reforms have led to governments' inability to address key public policy issues and implement the required changes, and to hasty, and sometimes counterproductive, decentralization programs. As a result of the above, policies are questioned and democratic institutions are weakened.

Evidence from the last few years also shows that capital flows and savings are key elements of growth. During the 1990s, *financial sector* reforms improved the institutions and mechanisms for bank regulation and supervision. Financial intermediaries were also strengthened. Pension system reforms helped expand capital markets and mobilize domestic savings. Despite all this progress, financial sector development has been inadequate. The region still has low levels of capital formation, a situation that limits the growth of a significant proportion of productive activities. In addition, international integration has had mixed impact on the financial sector. The lesson drawn from international experiences in this field is that the liberalization of capital accounts has helped to attract capital and reduce its cost, but has increased its volatility. In particular, this liberalization has not benefited the countries that did not already have policies and institutions in place to avoid pro-cyclical fiscal policy and excessive risk taking on the part of the financial system; in other words, in countries that have not met these conditions, integration has contributed to fiscal and financial vulnerability. Consequently, to increase economic growth, it is essential to develop sound capital markets, increase domestic savings, and promote actions to encourage greater access to international capital on a sustained basis.

The quality of *infrastructure* is another determining factor of the potential for economic growth. Privatization has been the main policy that Latin American countries have used over the last decade to improve service delivery in the electricity, telecommunications, and other infrastructure sectors. In fact, Latin America has been the leading region in the developing world in the area of privatization. Investments with private participation during the 1990s totaled US$252 billion, representing over 43 percent of the total invested in the developing regions. Currently, opinion surveys in Latin America consider that privatizations have not been beneficial

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

and many countries are debating whether infrastructure services should be in private hands or under government control. Experience has shown, however, that neither deregulation nor complete privatization of the sectors, nor total dependence on the public sector, can remove the obstacles that are limiting service coverage and quality. Better provision of these services requires measures to modernize the State, actions to improve the regulatory framework and the system of incentives to expand the role of the private sector, and, in some cases, cooperative efforts. For example, civil society organizations could provide water services to small communities, or groups of countries could improve road or electricity infrastructure.

Participation in world markets can also improve the potential for economic growth in the countries of Latin America. Compared with the previous decade, the increase in growth rates in the 1990s stemmed in large part from export performance, in such noteworthy cases as Costa Rica, El Salvador, Mexico or the Dominican Republic. These countries were among the most dynamic exporters in the world at the same time that they diversified their export base and improved their growth rates. However, trade integration has been less beneficial for low-income countries that are more dependent on natural resources, the prices of which have tended to drop, such as coffee and several minerals, or the productivity of which is too low to compete in international markets.

In the area of *regional integration*, there was a noteworthy expansion of sub regional and bilateral initiatives in the 1990s. In addition, during the last decade, there was a growing presence of developed partners for these initiatives. The benefits stemming from these processes have been clear, since liberalization for preferential reciprocal trade in goods has been rapid, universal, and consistent with the WTO. Some liberalization agreements have even advanced towards a "second generation", incorporating the areas of services, investment, and intellectual property, among others. However, many sub regional trade agreements with customs union and common market ambitions have encountered difficulties in terms of achieving such objectives. Persistent economic instability in some countries, limited scope and implementation of second-generation protocols, insufficient coordination of macroeconomic policies, and incomplete and/or inefficient common external tariffs are some of the factors behind such difficulties. Moreover, the countries have faced the need to effectively combine their sub regional objectives with important opportunities presented by agreements with industrialized countries and new WTO negotiations.

Experience also shows that social development is not only an objective for equity but also a necessary condition for achieving sustainable economic growth. It provides the foundations for improving labor productivity, through its contribution to the formation and maintenance of *human capital,* and supports the construction of *social capital*. In addition, it contributes to reducing inequalities related to income and access to the benefits of development and prevents the proliferation of social problems such as violence and exclusion, all factors that create an unfavorable climate for investment and productive activities, erode social capital, and make it difficult to fully harness human capital potential.

Another important lesson is that efforts to increase sustainable economic growth must necessarily include actions aimed at improving the productivity and income of the poor and excluded. Actions to promote sustainable economic growth and actions that directly benefit the disadvantaged are complementary in a great number of cases. Constraints on investment in human capital or credit rationing for the low-income population, the lack of basic infrastructure, exclusion based on geography or ethnic origin that prevents taking advantage of externalities, and the social polarization that can lead to inefficient

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

government practices are some of the factors that weaken incentives for capital accumulation, reduce productivity, and can lead to situations of persistent poverty, inequality, and slow growth.

In the context of *environmental sustainability*, environmental management must primarily seek to improve the quality of human life; promoting long-term productivity, the economic valuation of natural resources, efforts to reduce vulnerability to natural disasters, improvement of basic health, and respect for local cultural heritage. The World Summit on Sustainable Development in Johannesburg offers a framework of lessons on the progress achieved since the 1992 Rio Summit and reinforces the principles of sustainable growth, establishing that the objectives of economic growth, social development, and environmental management are necessarily interlaced in the context of sustainability.

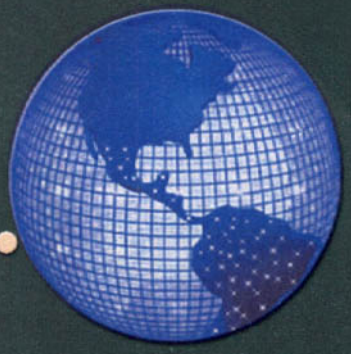
It is essential to have appropriate levels of environmental performance from the standpoint of public and private sector competitiveness. It is extremely important to pave the way for private-sector participation and public-sector investments through effective, transparent, and harmonized regulatory frameworks. Similarly, there are enormous opportunities for environmental/economic benefits to be derived from the adoption of ecologically efficient and less polluting production practices that cut production costs and mitigate negative social impacts. In addition, countries must be prepared to take advantage of the opportunities provided by the international markets for certified environmental services, including carbon markets, biotechnology, organic production, eco tourism, and others for which the region may enjoy comparative advantages.

With regard to the development of an effective management framework for environmentally sustainable development, it is important to recognize that the lack of effective incentives for environmental management and natural resource administration are at the core of the problem. Meanwhile, environmental problems feed, in part, on market failures such as externalities, inadequate property rights, and economic policies; especially subsidies that distort real market signals and favor overexploitation of natural resources and deterioration of the environment. There is therefore a need to address economic and sector policies more systematically in order to properly incorporate the environmental costs and benefits and the real economic value of natural resources.

Another important lesson, from the environmental perspective, is that the establishment of environmental institutions and laws is only a first step. The institutional response and public and private commitments towards environmentally sustainable growth require a broad framework of governance that effectively links central institutions, local governments, the private sector, and rural communities, and allows for the effective application of policies, procedures, management instruments, and for a wide and transparent dissemination of information in the context of participatory processes and consultation with civil society.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

AREAS FOR BANK ACTION



Taking into account the diagnosis and lessons learned, and pursuant to the mandate of the Bank's Eighth General Increase of Resources and Institutional Strategy, this section sets out the priorities for the institution's action to achieve the objective of sustainable economic growth.

The proposed framework for action is based on the recognition that macroeconomic stability helps to improve the private investment climate and provides budgetary certainty for public investment. Similarly, the quality of institutions, stable financial systems with broad coverage, infrastructure, and the quality of human capital contribute to investment processes and the productivity of existing assets, both public and private. In turn, regional integration and a good economic positioning in the context of globalization strengthen investment and create new opportunities for growth. For this reason, the actions that the Bank is proposing to develop address the following priorities: (i) strengthen the foundations for *macroeconomic stability*; (ii) improve the conditions for *competitiveness* for the development of productive activities, with special emphasis on the institutional and economic environment for the strengthening and stability of the financial systems and public infrastructure service sectors; (iii) increase the quality and coverage of education and health to promote human capital and *social development*; (iv) strengthen public institutions and improve the political climate in the context of *modernization of the State*; (v) promote *regional integration* and the countries' international positioning. Likewise, all these actions will be undertaken within an environmental perspective to ensure the sustainability of economic growth.

Based on the above, the actions to be undertaken by the Bank to help establish sound macroeconomic principles are presented below along with measures in the four priority areas of Bank's action for promoting economic growth (Competitiveness, Modernization of the State, Social Development, and Regional Integration). Actions with regard to the environment, as a cross-cutting area that will ensure the environmental sustainability of growth are also presented for each case. Table 1 in the Annex summarizes the actions to be described below.

As highlighted in the diagnosis, there is no single recipe or model for sustainable economic growth. Achieving results with regard to the priority areas identified requires devising, integrating, and executing various actions adjusted to the specific context of each country. The core elements for setting priorities and properly sequencing the various actions will be set out in the country strategies. Accordingly, the relationship between the strategies by priority area and the country strategy will be essential for achieving the objective of sustainable economic growth. The actions will also be closely linked to the targeted actions defined in the Poverty Reduction Strategy, in order to contribute to equitable and environmentally sustainable economic and social development.

ACTIONS IN SUPPORT OF MACROECONOMIC STABILITY

The Bank will promote the establishment of sound macroeconomic foundations and economic stability, including the fiscal, financial,

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

and external sustainability of the economies. Given the comparative advantages of the various international organizations, the Bank's actions in this field will focus on consolidating institutions for macroeconomic stability by strengthening tax systems and their administration; improving budgetary and fiscal management institutions; and strengthening fiscal institutions at sub national levels. In addition, the Bank will work in coordination with other international agencies to provide international liquidity in periods when external financial resources are temporarily scarce and to develop the financial mechanisms and international architecture that will make it possible to reduce the volatility of international financial flows.

Strengthening of tax systems and their administration. Tax regulations and administrative procedures should be simplified in order to enhance transparency and facilitate control. The Bank will support those countries that choose to grant administrative and budgetary independence to the tax collection agency, in order to reduce political interference and make the collection systems more transparent and efficient. One of the main objectives to these improvements on the tax systems is raising the effectiveness rate of both the income and the value added tax, which constitute the two main sources of tax revenues in the region. The effectiveness rate of these taxes is defined as the relation between tax collection (expressed as a proportion of GDP) and the basic tax rate.

Improvement of budgetary institutions and fiscal management. While the region has made progress in reducing public deficits, much remains to be done to improve fiscal management. Some key elements of the Bank's action in this regard may be related to supporting the countries in the drafting and implementation of legislation on fiscal responsibility and transparency, while at the same time providing assistance to the Executive and Legislative Branches to improve their capacity to carry out budget-related tasks, taking into account social equity, fiscal sustainability, and transparency. However, it should be taken into consideration that there is not an ideal system of budgetary institutions. In particular, to make reforms sustainable and credible their design should include the need for political and institutional control mechanisms in order to make reforms sustainable and credible.

Strengthening of fiscal institutions at sub national levels. In most Latin American countries, the taxation capacity of departments, states and municipalities remains underutilized. Policies aimed at strengthening taxation—at the sub national level—will aim to achieve adequate levels of collection from sub national governments either as a proportion of GDP or as a proportion of the total tax revenue of the country. The viability of these taxes depend on the size and density of the territorial units, and clearly, on the management capacity of the sub national governments. Among the most important measures that the Bank can promote among national governments in order to foster the taxing capacity at sub national levels are the updating of property registers and the clearing of property regimes of rural lands. The Bank will support measures to create mechanisms and incentives for improving collections, which requires sub national governments to have the authority to establish the tax bases and the tax rates within certain limits; use collections on an adequate basis; operate within a framework of decentralized responsibilities that will require them to be responsible for certain services to the local communities; and receive transfers of resources from the central government through a transparent, equitable, and non discretionary system.

Access to international liquidity in periods when external financial resources are temporarily scarce. The Bank can act as a stabilizing force in circumstances in which capital flows

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

to the countries in the region are interrupted, which is one of the causes of macroeconomic volatility. The objective of emergency loans will be to provide financial support to mitigate the social and economic effects of international financial crises. Since all emergency loans must be framed within a macroeconomic stabilization program endorsed by the International Monetary Fund and must be coordinated with the World Bank when appropriate, they will help to improve the general conditions of macroeconomic management. The Bank will also collaborate with these institutions to develop new financing mechanisms and new response and coordination modalities, in order to reduce the volatility of international financial flows to the countries. Among the new financing mechanisms is the establishment of a new export-credit system, which in particular will support those countries in which exchange and financial difficulties have affected the normal foreign trade financing mechanisms.

ACTIVITIES IN THE SECTOR AREAS FOR BANK ACTION

In addition to support for macroeconomic conditions, the basic actions proposed in this strategy to achieve sustainable economic growth have been grouped into the four areas of comparative advantage identified in the context of the Bank's Institutional Strategy: Competitiveness, Modernization of the State, Social Development, and Regional Integration. The principles and guidelines of each of these areas in support of sustainable economic growth are presented in this section. The strategy papers for each of these areas will set out the program of actions in greater detail.

Competitiveness

In the area of competitiveness, the core objective of the Bank's actions will be to help improve the institutional and economic environment for the development of the private sector's productive activities, in a context of economic, social, and environmental sustainability. The Bank believes that its main contributions in this field should focus on improving supply and facilitating access to key productive resources, such as financial resources and capital; human resources; infrastructure services, including energy, transportation, and telecommunications; knowledge and new technologies, especially information technologies; and instruments for cooperation between the public and private sectors for competitiveness. The Bank must also help each country define its own competitiveness strategy through processes of dialogue that serve to identify priorities for action and that generate an environment of cooperation between the government, the private sector, labor, and the main social actors.

Access to Financial Resources. The main obstacle to investment, growth, and competitiveness for Latin American enterprises is the scarcity of financial resources and the difficult access to credit, particularly for micro enterprises, small and medium-sized businesses, and independent producers. To achieve a modernization of financial systems that fosters competitiveness in the sector, increases access to financial resources, improves the efficiency of intermediation, and reduces the risk in credit activities, the Bank will support countries to strengthen regulation and financial supervision, develop capital markets, and strengthen property rights. The Bank has vast experience in supporting processes of financial sector reform which will be used to continue supporting countries adapt its regulation and supervision systems according to international standards, taking into account the priorities and possibilities for an efficient use of those standards according to the reality of each country. The Bank will also support the development of micro credit systems and other alternative institutions to expand access

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

to credit for micro enterprises, small businesses, and small producers, particularly the poor (this and other targeted actions are included in the Poverty Reduction Strategy).

Efficient use of human resources: Labor training, legislation and intermediation. The Bank can help countries to improve their use of human resources through actions in the areas of training, labor law, and collective bargaining. The Bank's longstanding tradition in supporting the education and training sectors must be drawn upon to implement ambitious reforms in job training mechanisms, with a view to introducing competition, expanding coverage, stimulating private-sector participation, and improving the relevance of the training provided. The Bank has also developed valuable experience with mechanisms for training of entrepreneurs, small producers, and workers. These actions are crucial, in particular for the strengthening of micro enterprises and small and medium-sized businesses, to improve their productivity and trade opportunities. The Bank's capacity to stimulate dialogue and promote consensus building must be used to seek changes in countries' labor laws and collective bargaining systems, in order to facilitate hiring processes in the formal sectors and improve employer-employee relations. Finally, the Bank will also support the consolidation of labor intermediation systems to facilitate the search for employment and improve workers' productivity.

Improvement in the provision of infrastructure services such as electricity, telecommunications, information technology, water and sanitation, roads, ports, and airports. The Bank has played a leading role in the modernization of most of these sectors. Despite undisputed advances in some of them, such as electricity, potable water, and highway concessions, the reforms are showing signs of fatigue and seem threatened in some countries. Accordingly, the action will focus on supporting the consolidation of the reforms, seeking to ensure sustainability through: the adaptation of regulatory frameworks to take into account the institutional and technical restrictions that impede achieving efficiency through competition in the delivery of services; the promotion of efficiency and modernization and expansion of the quality and regional coverage of services, taking into account environmental sustainability; the financing of infrastructure investment, including the design and implementation of new modalities to access national and international capital markets; and the support for the restructuring and sale of State-owned enterprises or advances in private participation processes.

Assimilation and development of new technologies. This area is essential for competitiveness and the Bank can play a leading role that will benefit in particular the less developed countries, small— and medium-sized enterprises, and small producers. In this area, the countries will be given support to: assess science and technology systems to identify their weaknesses and strengths; improve institutions that generate science and technology through integrated programs and organizations that generate science and technology knowledge; and strengthen intellectual property rights and accelerate the technical improvement of enterprises. In developing these activities, the Bank will promote partnerships between government, business, and entities that generate knowledge and technology. In particular, the Bank will support efforts aimed at disseminating the use of information technology by micro enterprises and small businesses and in rural areas.

Cooperation between the public and private sectors for competitiveness. The Bank has a key role as catalyst and support of dialogue and cooperation processes between the public and private sectors (including entrepre-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

neurs, workers, academics, and other social actors) to produce consensus-based strategies and action plans to improve the competitiveness of geographic clusters or branches of productive activities, and to advance processes of legal, institutional and administrative reform that facilitates the creation of enterprises, technological improvement, productive links between enterprises of different size, and productivity increases under environmentally sustainable conditions. Additionally, the Bank will promote Corporate Social Responsibility, given that it can turn into an important part of firms' success and competitiveness in very competitive global markets, and can generate valuable benefits to firms themselves and their stake holders, including employees, investors, suppliers, consumers, community and civil society organizations.

Finally, the *availability and quality of natural resources* are essential parts of the productive base of the region economies and contributing factors to the competitiveness of goods and services produced and exchanged by countries of the region. In order to strengthen environmental conditions affecting competitiveness, the Bank will support numerous actions and projects that: preserve and improve the endowment of natural capital as an element to develop environmental goods and services; increase factor productivity; enhance employment of clean production processes; and contribute to the competitiveness of the region through sustainable use of its natural endowment. Within this context, the Bank will support actions that, among others, enhance sustainable agriculture, basin/deep valley management, and the use of coastal marine and forest resources as well as eco-tourism. In addition, private sector participation will be sought in the area of environmental initiatives that make use of the comparative advantage possessed by the region in the context of global and regional market opportunities.

Modernization of the State

Modernization of the State is required if the chances for growth in the region are to improve. Economic sustainable growth requires a democratic, modern and efficient State. A modern State, in the context of a strong democracy and active citizen participation, is essential to guarantee an adequate relationship between the State and the market, which in turn assures the economic incentives on which sustainable growth depends. Consequently, the following priority areas and actions have been identified for Bank activity in the area of Modernization of the State.

Consolidation of the democratic system: Sustainable economic growth requires of an atmosphere of democratic and political stability that makes a sustained saving and investment effort possible. With this purpose the Bank will support the countries in the modernization and strengthening of representative institutions, such as legislative institutions, and electoral and political systems; the effective operation of supervision institutions that enforce the suppression of political power abuses; the effectiveness of decentralization processes in order to guarantee a balanced development of regions; and the promotion of democratic values between social actors and their strengthening as economic agents.

Strengthening of the Rule of Law: Sustainable economic growth requires legal security in the observance of rights and obligations, including the elimination of practices of corruption and clientelism, as well as barriers to access to justice that multiply the transaction costs and distort the incentives system. The Bank will support reforms that lead to the strengthening of judicial power independence; modernization of justice administration; existence of alternative mechanisms for conflict resolution; modernization of cadastre and property titling systems; update of mercantile, fiscal, financial and procurement

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

legislation, to make it compatible with coherent incentives for saving and investing; and citizen security programs that improve the climate for investment.

Strengthening of the relationship between State, Market and Society: Sustainable economic growth requires the promotion and development of transparent, competitive, efficient and inclusive markets. With this objective the Bank will support countries to strengthen the institutions for economic regulation and competition promotion to increase their effectiveness, and simplify the different levels of registration, control and supervision for private activity in order to avoid redundancies that reduce the incentive for productive activities. In addition, the Bank will support economic development agencies and institutions, both at the national and sub national levels, that increase economic opportunities for all sectors.

Modernization of Public Administration: Sustainable economic growth requires the existence of a modern, efficient public administration with autonomy from the interests of the individuals, able to formulate and execute policies and programs with efficiency, and able to provide public services. In order to contribute to the improvement of public administration and to support fiscal and budgetary institutions to attain macroeconomic stability, the Bank will support the strengthening of the capacity to formulate policies, specially for sustainable economic development; transparency in the management of public spending, by means of surrendering of administration accounts; the improvement of expenditure administration by establishing control and evaluation systems by results, and decentralizing them with market criteria; the profesionalization of public institutions, specially those in charge of economic administration, by establishing a professional civil service system; the modernization of public services by promoting competitive participation of markets and civil society in its provision; and the incorporation of the new technologies to improve public management in key areas, such as procurement, in which it is possible to simultaneously achieve greater efficiency and transparency.

Regarding the environmental dimension and its relations to the modernization of the State and economic growth, it is important to highlight that environmental governance is one of the founding principles of the Environment Strategy, compatible with the modernization of the State efforts. The creation and consolidation of a transparent and participatory framework for environmental management will be supported which will allow the determination of correct priorities for the sustainable use of natural capital and the quality of the environment. From an environmental perspective, the Bank will concentrate its attention in the strengthening of institutions, the participation of civil society, the strengthening of efficient environmental norms, and the development of adequate instruments for environmental management.

Social Development

The strengthening of social sectors is required not only for poverty reduction but also for the promotion of economic growth. In this respect, the main objectives should be to accelerate educational progress, promote access to education, health, and housing services, and consolidate coexistence based on respect that furthers the development of social capital. Accordingly, the Bank will cooperate with the borrowing countries in the review, consolidation, and financing of reforms in the sectors of education, health, and housing; the adequate use of human resources, in the context of the life cycle, through the promotion, for example, of adequate transitions between school and work, and the reform of social security contributions; the promotion of social inclusion, and

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

participatory mechanisms, social capital and the prevention of social conflicts and violence; and the delivery of basic social services with an integral approach at the local level. The Bank will support policies and programs that represent a good mix of initiatives for promotion, protection, and prevention, while seeking to balance short-term responses with long-term reforms and investments.

The Bank will emphasize social progress as a condition for economic development by consolidating the process of sector reforms in education, health, and housing. The Bank will seek to improve effectiveness, expand coverage, and enhance the quality of these services, in a way that is compatible with resource availability over the short, medium, and long terms. Better education, health, and housing conditions lead to higher labor productivity and higher revenues, which in turn have an impact on production and consumption.

Education sector reforms aimed at making the labor force more productive will focus on: universalizing the entire primary and secondary cycle; improving access to post-secondary education; improving the quality of education at all levels; adapting the educational curriculum to the needs of a dynamic and globalized labor market, especially at the secondary-school level; and improving preparation and training through reforms of technical and vocational training programs, in line with labor market needs.

Health sector reforms to obtain a healthy and productive labor force will focus on expanding access to quality health-care services at all levels of care, and supporting public health and primary health-care efforts, with emphasis on promoting awareness and preventing health risks. Given the importance of the first years of life to the development and learning capacity of individuals, the Bank will place special emphasis on nutritional programs and early intervention for pregnant and lactating women and children between zero and three years of age. The Bank will also promote childcare programs to enable women's full participation in the labor market.

Housing sector reforms seek to improve the operation of the markets for housing inputs —financing, serviced areas, and construction materials—to strengthen the sector's results in terms of number and quality of housing units provided to the population, and expand the sector's contribution to capital formation and the national product. The Bank will promote private-sector participation in the production and financing of housing, supporting the adoption, on the part of governments, of an approach that paves the way for the operation of the markets and the expansion and deepening of local financial markets.

Reduction of the barriers for human capital development through life cycle approach. To foster the adequate use of human resources, within the life cycle approach, the Bank will promote actions to facilitate transitions from school to the labor market. The Bank will look to articulate national systems of education and employment, as well as to promote the development of national skills standards that can be used easily by employers and training and technical and vocational secondary education institutions.

The Bank will promote reforms in social security systems financed through payroll taxes in order to: achieve adequate levels of social protection vis-à-vis the economic risks related to productive activity, and improve the efficiency of benefit systems, by reducing payroll costs associated with such systems. Effective protection from risks associated to productive activities promotes growth by allowing workers to participate in economic activities with highly variable incomes but greater returns, and increases the support to reform processes by allowing workers affected by these reforms to find other jobs.

Development of social capital for the promotion of social inclusion and the reduction of social problems. The reduction of social

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

exclusion, social conflicts and antisocial behaviors prevents economic losses and provides incentives to productive activity and investment. The Bank will support information dissemination and sensibilization programs, legislative and institutional reforms, reforms in the labor market that diminish discrimination, and programs that reduce social and domestic violence and avoid the emergence of new social conflicts. In addition, policy dialogues and programs directed to the construction of social capital will be promoted, as well as participative mechanisms that improve the capacity of individuals and communities to cooperate constructively in the production of goods and services and actions to foster the provision of social services by private suppliers and NGOs.

Promotion of social and economic development in local areas. In order to improve productivity and growth at the local economy level, the Bank will promote the delivery of basic social services with an integral approach at the level of localities. Actions in this area include improving of basic urban infrastructure at the local level, which is an essential component to improve its asset base, and promoting the integration of isolated localities to regional markets of goods and services.

The cross-sectional scope of the Bank's Environment Strategy establishes a direct and essential link between the *environment, social development and sustainable economic growth.* It recognizes that environmental degradation and natural resource depletion harm the quality of life, human capital and economic opportunities of the population. The concrete aspects that demand priority within the linkage between social development, the environment and economic growth are: health and the environment; rural development and natural resources management; and material vulnerability in the face of natural disasters and other environmental risks.

Regional Integration

Regional integration is a fundamental part of the structural reform process and a key element for improving the possibilities of achieving sustainable growth. For one thing, it combines with and mutually reinforces unilateral and multilateral liberalization efforts. Moreover, it provides guaranteed and regulated access to regional markets that are larger than the domestic markets. These larger markets promote economies of scale, greater competition and specialization, higher productivity, export experience with diversification, attraction of domestic and foreign investment, more complete capital, labor, and technology markets, etc., and functional cooperation in critical areas such as infrastructure. Sub regional integration, particularly when it enjoys political commitment and has deep objectives, presses these advantages by deepening and accelerating commercial ties between countries since they trade naturally with each other because of geographic proximity and demographic, cultural, historical, and geopolitical affinities. Finally, the emergence of north-south integration processes such as the FTAA or those with the European Union offer sub regional agreements the opportunity to consolidate new levels of commitment, gain access to large markets, maximize international comparative advantages not offered in the sub regions, import modern institutional arrangements, and attract foreign direct investment.

The Bank's priority actions in support of regional integration are related to: the consolidation of regional markets; the promotion of regional infrastructure; the strengthening of institutions; and regional cooperation.

A core objective for a successful integration process is to achieve *increased economic growth through the expansion of markets.* For this, the Bank will prioritize the following areas: the cost-benefit evaluation of options for integration; the opening of extra regional

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

markets; the elimination of tariff and non-tariff barriers for goods and services; the reduction of preferences that promote trade diversion harmful to welfare; the strengthening of integration processes for financial services; and the promotion of policies that support the dynamic transformation of production. In processes with deep objectives, the agendas can move forward easier when problems of access have been overcome, creating endogenous forces of integration through trade interdependencies. In these cases, the Bank also needs to expand its approach to include support in areas such as consolidation of efficient common external tariffs and the full establishment of customs unions. However, the Bank's support for the latter should be tied to effective progress by the countries in implementing their stated objectives. Alternatively, other less ambitious options, such as free trade areas, should be promoted.

The development of regional infrastructure makes it possible to increase the productivity of economic activities and expand their social impact. The Bank will provide or mobilize financing and technical assistance for national infrastructure projects that promote development within a framework of integration and regional infrastructure, including feasibility studies and assessments of social and environmental impacts, making an effort to maximize joint benefits, harmonization and modernization of regulatory frameworks and promotion of comprehensive development of border areas.

The Bank will promote institutional strengthening with the objective of establishing the rules and institutions required for viable and economically advantageous integration agreements. In this area the following actions will be given priority: strengthening of institutions that execute and monitor agreements; establishment of adequate dispute resolution mechanisms; preparation of national institutions to face negative impacts produced by the transition to free trade; promotion to agencies and credit instruments for exports; modernization of procedures and harmonization of standards; adaptation of tax systems; exchange of information and harmonization of policy measures between countries; agreements to avoid "fiscal wars" while attracting direct foreign investment; and options for macroeconomic cooperation and eventually monetary integration.

Support for cooperation in the creation of regional public goods in areas that promote economic activity and take advantage of externalities. Actions should focus on areas such as: the establishment of regional codes and rules; improvement and harmonization of financial regulation and supervision; labor mobility; promotion of cooperation for socioeconomic development for border areas; high-level horizontal cooperation to promote institutions and policies of economic development; and coordination between donor and regional countries.

The *cross-sectional nature of environmental topics carries relevant and important connotations in the context of regional integration*, which are detailed in the Environment Strategy. The environmental dimension is included as a priority area for regional integration and does not limit itself exclusively to the mitigation of negative environmental impacts, but includes as well the generation of opportunities based on high value environmental goods and services generated within a regional and cross-border context. The following environmental issues of regional integration are of priority importance for the Bank: strengthening of regional institutions related to the environment; management of regional environmental public goods and services; and, environmental quality within regional infrastructure initiatives.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



OPTIONS FOR BANK SERVICES AND IMPLEMENTATION GUIDELINES

This Sustainable Economic Growth Strategy provides a framework, which defines general principles to guide the priority areas of action supported by the Bank. The effective implementation of this strategy will occur through the execution of the action plan defined in each one of the strategies of the four priority areas of Bank activity: Competitiveness, Modernization of the State, Social Development and Regional Integration, as well as those defined in the Environmental Strategy that has a cross cutting nature. As previously stated, these strategies are aimed at the promotion of actions and policies needed to achieve sustainable economic growth. The services provided through Bank activity are defined by the organizational framework of the IDB Group, which includes: the Bank's public and private action; and in coordination with the Inter-American Investment Cooperation (IIC) and the Multilateral Investment Fund (MIF).

The IDB Group has a variety of financial instruments to contribute to sustainable economic growth in the region, including investment loans, sector loans, emergency loans, several modalities of operations with the private sector (loans, guarantees, equity investments, etc.), the social entrepreneurship program, flexible lending instruments, and technical-cooperation financing mechanisms (reimbursable and non reimbursable). In addition to these instruments, the IDB Group also has non-financial services that include technical assistance and support for diagnostic assessments by area and for the design and implementation of strategies and policy dialogues; workshops, fora, seminars, and conferences; research activities; and the generation and dissemination of best practices and lessons learned.

Through the instruments at its disposal, the IDB Group provides support for a better response to the challenges and demands that arise in the region. Nevertheless, a programmatic framework that fully integrates and focuses its efforts is essential. In order for this range of available instruments and services to meet the objectives of sustainable economic growth and sector development, they need to be integrated through the country programming processes, using a selective criteria that takes into account the country needs, the Bank's comparative advantage, and the effectiveness of the various possible interventions. Integration implies coordinating the sequence of reforms and operations in areas and sectors handled by different departments to formulate packages of measures for individual countries that mutually reinforce and complement each other. It is important to stress that the activities described below will be carried out in close coordination with other national and multilateral development institutions and the private sector, in order to avoid duplication of effort and take advantage of the synergies of complementary interventions. The level of coordination of these measures could make the difference in terms of growth.

In the context of Country Strategies, programming priorities and actions must be identified in order to ensure the quality of project design and mainly the successful execution of projects, to strengthen the effectiveness of the Bank's contribution. The Country Strategy Guidelines approved by the Board of Executive Directors (document

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

GN–2020) define the appropriate operational framework for implementing actions at the country level that is consistent with the mandate set out in the Institutional Strategy (document GN–2077). In this regard, it is essential that the strategic framework be formulated for each country according to the guidelines approved by the Board of Executive Directors in document GN–2020, with the analytical and procedural precision recommended in the document, which provides for an implementation framework for key actions in terms of: programming; design; and execution of operations. In addition, the actions required to support these key actions in the areas of research and analysis, identification of best practices, and knowledge dissemination are identified.

Bank programming activities. In terms of programming, the Bank has relied on dialogue instruments that have provided a quick response to the demands of the governments. Yet, in line with document GN–2020, a more strategic programming framework is required, based on sector diagnostic assessments, involving a wide range of actors and close coordination with other available sources of financing. In this regard, the Bank will strengthen the theme of sustainable economic growth in key documents and actions that guide its programming activities in borrowing countries: sector assessments by country, dialogue documents, policy dialogue meetings (*encerronas*), country strategies and respective updates, work programs and portfolio reviews. In dialogues with national authorities, country divisions with the collaboration of functional divisions, central departments and the Country offices will stress the strengthening of actions directed to achieve sustainable economic growth. The Bank will aim to convert the country strategy into a focal point for the implementation of the strategy; nourished by the products provided by sector assessments by country, and relevant analysis and research for decision-making.

Dialogue and Country Strategy as a focal point of the strategy. To move from a simple agreement on the lending program to a coherent strategy, it is necessary to focus on the dialogue and Country Strategy and selectively agree with the countries on the lines of action that, based on the joint preparation of a comprehensive diagnostic assessment by sector, make it possible to define specific priorities and the sequence of Bank actions. To this end, it is essential, first, to have flexible and timely technical-cooperation instruments to provide adequate support, beginning with support for the comprehensive diagnostic assessments by area that identify priority sectors and problems requiring Bank action and program sustainability. Second, investment loan operations have to be organized and prioritized for all the facilities, with and without sovereign guarantees—the Bank (PRI and Regional Departments), the MIF, and the IIC—in such a way that a clear signal is received on what priorities have been established in the agreed strategy and of the Bank's commitment to its implementation.

The Country Strategies' analysis of the main barriers to sustainable economic development will take into account the close relationship between sustainable economic growth and attainment of the Millennium Development Goals (MDGs). The country strategies will take account of existing gaps that need to be bridged to fulfill the various MDGs and the resources needed to do so. In addition, the Country Strategies will seek to promote actions to achieve growth levels consistent with fulfillment of the MDGs. Moreover, the synergies arising from the dual causality between the MDGs and growth will be taken into account, emphasizing actions that allow for the most progress to be made simultaneously towards both goals. It is important to stress that, in order to support fulfillment and monitor progress towards the MDGs, both at the regional and national levels, the Bank will establish strategic partnerships with other donor institutions—both

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

multilateral and bilateral—that exploit the comparative advantages of each of these institutions.

Sector assessments by country. The Bank will analyze the main barriers to sustainable economic development in the borrowing member countries, from a sector dimension. In the past, assessments underpinning programming documents have been predominantly general in nature, with little integration among sector references. It is essential that sector assessments be coordinated and integrated. The diagnostic assessment by country will be based on a series of sector studies (conducted by the country, the Bank, or other institutions) focused on establishing priorities for the Bank's action. It will serve as the basic input for full inclusion of the issues related to sustainable economic growth in the programming process. The scope of the assessment would cover the spectrum of problems or challenges and would involve the active participation of the various stakeholders in the sector—from both the country and the Bank.

Project and program design. The Bank must support actions aimed at improving and encouraging quality in the formulation of projects and programs. This means identifying and implementing a set of incentives to promote more systematic work with regard to: timely and appropriate access to financing resources for project design; the systematic incorporation of lessons learned and the dissemination of information and best practices; the coordination/integration of cross-cutting themes among operational divisions and departments within the Bank as well as with bilateral and multilateral financing agencies

Access to technical-cooperation financial resources for project design. Currently, project teams and technical counterparts in the countries do not always have sufficient resources for the design stage of projects, either in terms of adequate amounts, adequate time for their use, or restrictions on the focus and scope of the technical assistance, depending on the technical-cooperation trust fund providing support. As part of the implementation of strategies in priority areas and country strategies, it is important to identify processes that will reduce transaction costs involved in using resources and make technical assistance more flexible.

Coordination/integration of horizontal themes. It is essential to improve coordination among financing agencies (bilateral/multilateral), and among divisions and departments within the Bank, especially in critical cross-cutting areas such as rural development, modernization of the State and decentralization, management of local development funds, and environmental management, in order to avoid duplicating efforts and sending contradictory signals on development processes. This requires establishing a mechanism of incentives to promote, reward, and guarantee the coordination and integration of efforts in project design.

Execution of operations and programs. The Bank has a direct influence on the achievement of development objectives and targets, therefore this aspect of the Bank's project and program cycle is extremely important. The Bank's projects have evolved towards complex reform programs, which require that, at the country level, the executing agencies and the Bank's Country Offices have the technical, professional, and financial instruments to monitor these reform processes. Some of these instruments include: flexible and timely access to technical assistance in the field during execution of the programs; formalization of operational audits annually or during execution of the programs (supplementing the financial audits) of a technical nature (institutional, environmental, economic); monitoring of key performance indicators; systematization of lessons learned

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

and feedback for new projects; and development and training of professionals consistent with the demands stemming from the new projects.

In the context of project and program execution, easy and timely access to technical assistance resources to support the consolidation of sector programs and reforms is also very important as a way of providing ongoing and timely support for the implementation and consolidation of complex processes. Such processes include regulatory and institutional frameworks, execution of studies on priority areas, development of new markets, harmonization of legal frameworks, execution of large investment projects, support for the development of local capital markets, evaluation and dissemination of reform, impact and environmental monitoring. While project designs in some way incorporate these aspects as part of the countries' financing, it is important for the specialists in charge of execution at the Bank's Country Offices to have flexible and easy access to these types of resources.

Support for strategy, policy, and program monitoring and evaluation. As established at the recent Conference on Financing for Development in Monterrey, measurement and monitoring of the effectiveness of actions in support of development requires special attention. To that end, mechanisms need to be established to monitor the implementation of Bank programs and actions, with indicators and monitoring and evaluation systems for policy, program, and development target tracking. The Bank's resolute support for monitoring and evaluation capacity development, with participatory elements, is crucial to be able to improve, adjust and adapt policies for sustainable economic growth on the strength of lessons learned.

Research and Analysis. The economic theory of growth and development is a field of constant innovation. The Bank must be at the forefront in generating and disseminating knowledge in this regard. In particular, its policies and programs to ensure sustainable economic development must be designed and updated periodically. Crucial items on the research agenda will include, among others: the political economy of growth and development; sequence and dynamics of the processes involving reforms, regulation, and institutional change; governance and the processes of modernization of the State; determinants of equity and social development; sustainability of sector reforms; factors for competitiveness; functioning of financial and capital markets; and environmental sustainability factors.

Best practices and lessons learned in policies, programs, and projects. This is a vital area for the formulation of policies, programs, and projects. Accordingly, the Bank needs to strengthen its role in the development and dissemination of best practices for policy and program design in the area of promotion of sustainable economic growth, so that successful efforts may be replicated when timely and relevant.

Dialogue and knowledge dissemination: conferences, fora, networks, seminars, and workshops. One of the Bank's advantages is its capacity to promote and maintain long-term agendas in the region, particularly in the context of changes in government as a result of power changing hands. The Bank will continue to foster and facilitate dialogue and consensus-building in the area of adequate policies required to achieve sustainable economic growth. To pursue that objective, the Bank will use the following instruments: organization of regional policy dialogues among senior public officials; and regional seminars and conferences on issues pertaining directly to relevant policies.

Action Plan. The implementation of the Sustainable Economic Growth Strategy requires

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

a set of actions to strengthen ties between the strategy, the programming exercises, and the Bank's project cycle. As was mentioned above, this strategy is underpinned by the action plans of the priority area strategies and the monitoring of indicators that each strategy defines in more detail. The following elements are included among the priority lines of action to implement the sustainable economic growth strategy:

- The development of sector and country diagnostic assessments that evaluate in a comprehensive way the determinants of sustainable economic growth and identify bottlenecks and opportunities for competitiveness and environmentally sustainable growth.
- Pre-programming and programming exercises based on sector studies and diagnostic assessments, as well as high-level meetings ("encerronas") and dialogues with the government, the private sector, and civil society in general.
- Joint coordination events with multilateral and bilateral institutions to support countries in accomplishing sustainable economic growth targets, taking into account in the framework of the MDGs and, in particular, those related to environmental sustainability.
- Reinforced inter— and intra-departmental coordination within the IDB Group to achieve adequate harmonization and use of lending instruments and windows focused on the objective of sustainable economic growth. Management will promote actions that encourage the coordination of efforts for purposes of achieving sector goals and those identified in country strategies.
- The systematization of lessons learned processes at program design and execution stage in order to introduce best practices on a timely basis and thereby achieve quality results in the Bank's operations.
- The strengthening of country and Bank capacity building to evaluate the impact of Bank projects on sustainable economic growth in the priority areas indicated in this strategy.
- The creation and implementation of an internal incentive-based mechanism that promotes, rewards and guarantees coordination and integration of efforts between Bank departments and divisions in project design in critical cross-cutting areas for sustainable economic growth.
- The creation of a Knowledge Bank for Sustainable Economic Growth that integrates and consolidates databases, lessons learned and best practices of projects and policies in the areas of sustainable economic growth, including LERN and the Best Practices and Lessons Learned section of the SDS web site.

The integral plan of implementation of the sector strategies includes the required efforts to implement the objective of sustainable economic growth, as well as a timeline for implementation of actions.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

MONITORING, EVALUATION, AND PERFORMANCE INDICATORS



The Bank's decisive support for the development of monitoring and evaluation capacities is crucial to improving, modifying, and adapting policies and programs on the basis of lessons learned. Evaluations of projects representing the various priority areas of the Bank's action with the countries need to be incorporated. Thus, project designs must include basic elements that allow for a careful evaluation of the project's outcomes and impacts.

The strategy requires a results-oriented approach, which means the ability to monitor and evaluate the Bank's actions in the countries. This task will be supported by the work currently being carried out by the Bank to improve the measurement of the development effectiveness of operations (i.e., consolidation of each phase of the project cycle; programming and design of projects with a goal-oriented focus; and results-based project execution). The strategy calls for an appropriate and timely measurement of progress towards achieving sustainable economic growth goals through the different priority action areas of the Bank.

The monitoring and evaluation of the strategy's implementation will be performed, in principle, through indicators to measure outputs, outcomes, and impacts. The monitoring of the strategy will use such indicators and will be complemented by the analysis of experts and analysts from academic centers. To enhance the evaluation capacity of actions in favor of sustainable economic growth, the Bank will maintain efforts to develop methodologies to evaluate the effectiveness of specific projects and programs and to incorporate such methodologies in project and program design. Ex post evaluation is difficult to conduct when the mechanisms to generate the information necessary for the evaluation have not been incorporated into the projects from the beginning.

Output indicators: At this level, the Bank's contribution to the general strategy of sustainable economic growth will be measured. For each country, the priorities will be reflected in the country strategies, where the specific actions and interventions will be proposed depending on different country scenarios based on diagnoses and sector studies. Monitoring should be part of the periodic documents reviewing Bank's portfolio execution and be based on indicators set out in country strategies. In particular, before the end of the year 2005, the proposal is to incorporate in the Country Strategies actions to obtain sustainable economic growth that are based on integral sector diagnostics.

Outcome indicators: These indicators include a summary of outcomes of loan operations and non financial products by priority area, measuring their contribution to the promotion of sustainable economic growth. Outcome indicators that help perform the monitoring will be included during project design.

Impact indicators. At this level, progress towards the final objective of the strategy—sustainable economic growth in the borrowing member countries—will be measured. Indicators for macroeconomic growth and stability will be monitored, including the growth rate in real GDP, per capita GDP, inflation, fiscal position (deficit/surplus),

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

balance of payments, and savings and investment levels. In addition, in the context of environmental sustainability, the following indicators will be monitored: GDP adjusted for environmental costs, genuine domestic savings, and specific indicators on environmental quality and the status of natural resources. In addition, key indicators related to the strategies of the priority areas will also be monitored.

It should be noted that the Millennium Development Goals agreed upon at the September 2000 United Nations Summit call for achieving various objectives, including incorporating the principles of sustainable development in the country policies and programs and reversing the loss of natural resources. The specific nature and methodology of the indicators on environmental performance and the sustainability of natural resources are determined in the context of the Environment Strategy, taking into account the MDGs and the goals of the World Summit on Sustainable Development held in Johannesburg in September 2002.

It should be cautioned that there is an intrinsic difficulty of monitoring given that the conditions of sustainable economic growth in a certain country depend on a set of factors beyond those produced through Bank action in the course of various investment projects in the diverse priority areas. Given the importance of these exogenous factors—which frequently have a predominant effect—it can be difficult to attribute changes observed in the situation of the various areas of action referred to in this strategy to projects and other Bank activity. Not withholding these limitations, impact indicators are considered essential to help countries and agencies of international cooperation monitor the progress made in countries of the region.

The implementation of this strategy will depend on the priorities established by the countries, the circumstances that they face and available resources. An evaluation of the strategy that distinguishes between the areas of action that are the Bank's responsibility and those which are the countries' responsibility will be made after five years of its approval.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



Summary Areas for Bank Action

Box 1: Sustainable Economic Growth

Support of macroeconomic stability

Strengthening of tax systems
Improvement of budget institutions
Strengthening of fiscal institutions at the sub national levels
Access to international liquidity in times of crisis

Competitiveness

Access to financial resources
Efficient use of human resources: Labor training, legislation and intermediation
Improvement in the provision of infrastructure services
Assimilation and development of new technologies
Cooperation between private and public sector for competitiveness
Availability and quality of natural resources

Social Development

Reforms in education, health and housing
Development of human capital through the life cycle approach
Development of social capital
Promotion of development in local areas
Environment and Social Development

Modernization of the State

Consolidation of the Democratic System
Strengthening of the Rule of Law
Strengthening of the relationship between State, Market and Society
Modernization of public administration
Environmental Governance

Regional Integration

Access to markets
Development of regional infrastructure
Institutional strengthening for integration agreements
Cooperation in the creation of regional public goods
Environment and Integration

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

POVERTY REDUCTION AND PROMOTION OF SOCIAL EQUITY

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This document was prepared in SDS/POV by Gustavo Yamada (Project Coordinator), Omar Arias, and César Bouillon, as part of a team led by Carlos M. Jarque (Manager, SDS), the assistance of Maria Lourdes Gallardo, Jose Montes, Aura Oradei and Luis Tejerina (SDS/POV), contributions from Carlos Herrán (RE1/SO1), Charles Richter (RE2/OD3), Amanda Glassman (RE3/SO3), Eduardo Lora (RES), Fernando Quevedo (INT/ITD), Mayra Buvinic (SDS/SOC), Edmundo Jarquín (SDS/SGC), Anne Deruyttere (SDS/IND), Gabriela Vega (SDS/WID), Rubén Echeverría (SDS/RUR), Ricardo Quiroga (SDS/ENV), Luis Fierro and Natalie Pazmiño (SDS/SDS), Paz Castillo-Ruiz and Tito Velasco (SDS/POV), suggestions from many other Bank officials and various consultative groups composed of representatives of governments, academia, and civil society at the national and regional level, and comments received via the Bank's Internet website. The authors express their thanks for all these contributions and for the participation of Nora Lustig at the initial stage of document preparation.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

OBJECTIVE



The Bank's firm commitment to poverty reduction and the promotion of social equity in Latin America and the Caribbean has been manifested in its successive capital replenishments. In continuing pursuit of those priorities, in the framework of the institutional strategy, poverty reduction and social equity enhancement and sustainable economic growth are singled out as the Bank's two overarching objectives. The institutional strategy further states that the Bank will pursue cross-cutting initiatives in four priority areas—competitiveness, social development, modernization of the State, and regional integration—to help improve living conditions for the region's population, emphasizing those living in poverty.

Heads of State from the region recently pledged renewed efforts to achieve the Millennium Development Goals, specifically the target of halving, between 1990 and 2015, the proportion of the population living in extreme poverty. On the social equity front, there is a need to reduce disparities in income, assets (including human capital) and other multiple aspects of well being that are impediments to the region's social and economic progress.

The objective of this strategy is to promote faster progress in the reduction of poverty by tackling its root causes, fostering inclusion and greater social equity as a sine qua non of development. The strategy's starting point is an examination of recent developments in the region and lessons learned in combating poverty and social inequity and it updates the Bank's previous Poverty Reduction Strategy (GN–1894–3), approved in 1997.

The strategy takes a multidimensional approach to poverty, looking at a number of interrelated issues that have a bearing on human welfare: income and asset levels too low to meet basic needs; low human development; the inability of the poor to shield themselves against and manage shocks that can erode their income or assets; vulnerability to social problems; and barriers to economic, political, and social participation on an equal footing. A comprehensive poverty reduction strategy requires specific action on all these fronts. Such a strategy also requires explicit consideration of environmental sustainability.

This strategy document proposes a series of priority actions to guide the activities and services in this area of the IDB Group, underpinned by a diagnostic assessment and lessons learned about effective poverty reduction and social equity promotion policies and programs. All of the Bank's financial and nonfinancial activities, particularly its support in the four priority areas of the institutional strategy, should effectively help the region's countries achieve their poverty reduction and social equity goals. The document also proposes guidelines and actions for implementation, and includes indicators to track progress in this regard.

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub



DIAGNOSIS

According to the most recent data, Latin America and the Caribbean achieved a relative reduction in poverty in the 1990s, but the gains were modest. Taking as a poverty yardstick the percentage of the population earning less than two dollars a day in purchasing power parity, the region is beginning the twenty-first century with one third of its population—roughly 180 million people—living in poverty.[1] On average, their income is 45 percent below the poverty line. Poverty incidence is highest in the low-income countries, among them the heavily indebted poor countries (HIPC). However, most of the poor are concentrated in the largest and middle-income countries. The five most populous Latin American and Caribbean countries have around 70 percent of the region's total poor.

Different studies point to a reduction of just over 10 percent, since the early 1990s, in the share of the population subsisting below the poverty line.[2] However, because of population growth, the number of absolute poor did not decline in the past decade. Moreover, the incidence of poverty is higher than at the outset of the 1980s. Additionally, recent evidence indicates that some of the modest gains made in the 1990s have been reversed as a result of the economic slowdown and crises in various countries during the past two years.

Poverty is most acute in the countryside, the incidence of rural poverty in the region (59.1 percent) being more than double the urban figure (26.1 percent). Nevertheless, given the rapid urbanization and rural-urban migration throughout the region in the past few decades, the numbers of rural and urban poor are very close, accounting respectively for 49.6 percent and 50.4 percent of the total population living in poverty. Poverty is concentrated in households whose heads are employed in agriculture and in the urban nonfinancial services sectors (35.5 percent and 29.1 percent, respectively, of the region's poor).

Poverty in the region is strongly associated with low levels of education. The incidence of poverty in house-holds headed by persons with no more than primary education (41.3 percent) is more than eight times higher than in households headed by individuals who hold a post-secondary diploma (5.1 percent). The incidence of poverty is also more predominant among indigenous and Afro-descendant groups. In countries like Brazil, Guatemala, and Peru, poverty levels of these groups are double the figure for the rest of the population. In urban settings, poverty is higher among female heads of household (30.4 percent) than among their male counterparts

[1] Estimated from household surveys in the region. The two-dollar purchasing power parity (PPP) daily poverty line is considered to be an adequate basis for poverty comparisons among the countries of the region, given their relative development level. The base year is 1985. The region's poverty profile summarized in this section was constructed using that poverty line. Note that both the one-dollar and two-dollar PPP per day thresholds are being used for Millennium Development Goal tracking purposes.

[2] The characterization of poverty trends faces methodological issues. Nevertheless, recent studies using different methods all point to a moderate decline in poverty in the 1990s.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

(25 percent). Even further, these figures do not consider possible gender inequity within the household.

A number of factors are behind the region's limited progress in poverty reduction in the past decade. A succession of economic crises and natural disasters in some countries worsened poverty and underscored the vulnerability of large segments of the population. Renewed economic growth in a number of countries did little to reduce poverty because of the increase in wage and income disparities associated with skilled-biased technological change and the transitory impact of trade and financial market liberalization. Income inequality measured by the Gini coefficient increased or remained constant in most countries in the region between 1990 and 1999. Sufficient progress has not been made in reforms in support of more effective tax collection and better management of public social spending. In particular, increases in public social expenditure in most countries had only a modest impact because of its insufficient level; insufficient program targeting, and, in some cases, inefficient allocation and use.

The countries in the region are among the most inequitable in the world. In the late 1990s, the wealthiest 20 percent of the population received some 60 percent of the income, while the poorest 20 percent only received about 3 percent of it. In most countries, inequity is higher than the expected levels corresponding to per capita income levels. This is due mainly to the fact that, despite major political and institutional changes over the past decades, large disparities persist in asset distribution between high— and low-income groups, various ethnic groups, men and women, rural and urban areas, and/or more developed and less developed regions. In particular, although inequities in ownership of and access to land and credit are significant, several studies show that a very significant part of income inequity is due to important differences in the level and quality of human capital and returns on that capital, and to gaps in compensation associated with gender and ethnicity.

One important consideration from the outset is that poverty and inequity involve more than just income shortfalls and disparity. That being the case, the income measure of poverty does not capture the important strides made by the region's countries in other spheres of human welfare. Their significant gains in human development indicators are a case in point. The region's declines in child mortality are among the sharpest in the developing nations. Average years of schooling have risen. As part of the growing urbanization trend, countries have extended coverage of basic utility services, attending to some basic needs of the poor.

Consequently, the region has made progress toward a significant number of the United Nations Millennium Development Goals. However, without determined action to reverse current trends, many countries of the region could potentially fall short of poverty reduction targets. The following is a snapshot of the current state of progress toward some of these goals, from recent preliminary statistics:

- *Halve, between 1990 and 2015, the proportion of the population living in extreme poverty*. Progress toward this goal has been too slow in the past decade. There has been about a 10 percent reduction in the share of the poor in the total population measured by the poverty line of under one dollar a day PPP (purchasing power parity), and roughly a 13 percent drop using the yardstick of less than two dollars a day PPP.
- Achieve universal access to primary education by 2015. The region has made adequate progress toward this universal access goal, its net primary enrolment ratio having climbed from 89 percent in 1990 to 97 percent in 1998. The recent Summit of the Americas proposed a more

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

demanding goal for 2010, incorporating issues such as the quality of education, universal access, primary school completion for both boys and girls, and 75 percent secondary school coverage for youth. With respect to the advance on this goal, almost 60 percent of children in secondary school age in a group of countries of the region were enrolled in school at the end of the nineties.

- *Eliminate gender disparity in primary and secondary education by 2005.* This goal will mean consolidating the gains achieved in the majority of countries in the region, which by the early 1990s had virtually closed the basic-education enrollment gender gap. Between 1990 and 1998 the ratio of girls to boys attending primary and secondary school held at around 99:100.
- *Reduce by two thirds, between 1990 and 2015, the under-five mortality rate.* Since 1990 the region has made fairly rapid progress on lowering these indicators. By 2000 the under-five mortality rate stood at 36.7 per 1,000 live births, down 26 percent from 1990. In infants (children under one), a 30 percent decline in mortality, to 29 per 1,000 live births was achieved by the close of the decade.
- *Reduce by three-quarters, between 1990 and 2015, the maternal mortality rate.* Unfortunately, the figures available on maternal mortality are not reliable. The statistics available for the past five years suggest that the relative progress that had been made in the region in the early 1990s has leveled off. However, given the increasing trend in the coverage of reproductive health programs, prenatal care, and the proportion of births attended by skilled health personnel, there are prospects for improvements provided the leading risk factors for maternal mortality are addressed.
- *Halt by 2015 and begin reversing the spread of HIV/AIDS, malaria, and other major diseases.* Over the last four years, HIV/AIDS prevalence in adults between 15 and 49 in Latin America appears to have stabilized at a rate ranging between 0.5 percent and 1 percent, but in the Caribbean region the rate is around 2 percent. Overall, the HIV epidemic is more widespread in men, though the infection rate in women is rising quickly. In other epidemics, such as malaria and dengue, some progress was made during the 1990s, although the infection rates in certain geographic areas remain a cause for concern.
- *Ensure environmental sustainability.* International targets for this goal and for the global partnership for development goal await further refinement of their quantitative goals and performance indicators. Among the issues raised at the last Summit on Sustainable Development held in Johannesburg, it was noted that the region has made considerable progress in providing safe water and sanitation service to more of its people and that the percentage of the population without access to those basic services dropped by one fifth from 1990 to 2000. However, results were not as promising in other areas, for example, one serious concern for the region is that in the 1990s 14 of its countries were on the list of the 40 nations with the fastest deforestation rates in the world.

It is important to understand that regional averages for country indicators in Latin America and the Caribbean mask wide disparities in income, assets (including human capital), social indicators, and quality of life between countries that are at differing stages of development in the region and, particularly, disparities within individual countries. For instance, while the poorest 20 percent have completed only four years of schooling on average, the wealthiest 20 percent have completed ten years. Primary school enrollment ratios are generally lower for children of

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

indigenous and Afro-descendant families, and young people from these households have higher repetition and dropout rates. Gender gaps are also significant, particularly where ownership rights to family assets are concerned. Child mortality and malnutrition rates in the poorest areas and among low-income groups are typically significantly higher than in the more prosperous regions and segments of the population. In countries for which data are available, child malnutrition is more than three times more prevalent in the bottom income quintile than in the top fifth. Under–5 mortality rates are usually higher in the countryside than in towns and cities. The poorest also are the least likely to have safe running water.

These huge disparities are a barrier to poverty reduction and economic and social development in the region. As will be discussed later, these persistent inequities in the region not only make it far more difficult to achieve poverty reduction with the attained economic growth but can also dampen countries' growth potential. This is why economic and social development goals for the region also need to encompass specific goals for the poorest population groups, the excluded, and the geographic areas that are lagging behind.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



LESSONS LEARNED

A comprehensive poverty reduction strategy requires a cohesive package of actions on the economic, social, and political front to make sure that the poor population shares in the fruits of progress.

How quickly growth reduces poverty depends on the initial level of inequality and the pattern of growth. Since many of the region's nations are among the most unequal in the world, the region will need a considerable growth effort to achieve significant reductions in poverty. With no change in the income distribution, the region will need annual growth in per capita income of at least 4.0 percent, more than double the average in the 1990s, to achieve the goal of halving, by 2015, the percentages of the population living on less than one dollar and less than two dollars a day (in purchasing power parity). For countries with a high poverty incidence, the growth effort will be even stronger. Central American per capita growth rates, for instance, will have to be almost three times the average of the region in the 1990s to reach the goal.

Evidence from a number of studies and experience in the fight against poverty show that while sustainable economic growth, macroeconomic stability, and governance are key ingredients for poverty reduction, they are not sufficient. What is needed, also, are *specific actions* to promote greater equity and to increase the impact of growth on poverty. To this end, the strategy includes a set of activities designed to simultaneously create productive opportunities for the poor and excluded; give them better access to physical and social infrastructure; tackle structural inequities in the distribution of assets (particularly in the area of education); address social ills that disproportionately harm the quality of life of the poor; lower the social barriers that leave ethnic groups and women at a disadvantage; promote a more efficient, effective State that is more inclusive and sensitive to the needs of the poor, more accountable, and better recognizes the human rights of the poor; and establish comprehensive social protection systems. A large part of these activities will address the main aspects of the high inequality in the region.

The specific actions to improve the living standards of the poor, like the ones included in the previous paragraphs, and policies for sustainable economic growth that increase overall per-capita income and productivity do not necessarily oppose, and in many cases complement each other. As pointed out in the Sustainable Economic Growth Strategy, an increasing number of studies indicate that effective and targeted policies to combat poverty and inequity may likewise contribute to growth. For example, addressing the limitations that the poor face when market imperfections are combined with fixed investment costs and a minimum profitable scale increases the ability to invest in physical, human, natural or social capital, key factors for economic growth. In addition, addressing the limited access of the poor to productive and financial activities improves competition and efficiency in resource allocation, promoting economic growth. The development of the physical and social infrastructure of excluded groups and communities, and the elimination of discrimination,

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

which reduces the returns on their investments, may help increase productivity. Poverty and inequality can also dampen countries' growth potential by virtue of their relation to social and political equilibria. The kinds of social problems that are sometimes linked to poverty and inequality—crime, substance abuse, violence, and so on—can trap the poor and exact high economic costs that block a country's growth prospects. In an environment of social injustice, discrimination, weak recognition and protection of human rights and lacking in political participation avenues, poverty can trigger social upheaval and threats to public safety, once again dimming a country's chances for growth. Distributional conflicts can beget populist redistribution policies or inefficient political practices (inefficient tax systems, unproductive spending, and corruption) that weaken capital accumulation incentives and lead to sub optimal investment equilibria. Addressing these issues would have a positive impact on growth.

From the reasons listed above, comes the conclusion that a lack of direct attention to problems of inequity and social exclusion may lead to situations of persistent poverty and inequality, and of low levels of growth, which indicates the double causality.

Drawing on these considerations, two sets of factors are necessary to reduce poverty reduction and promote social equity. *General requirements* have to do with core elements comprising a framework for sustained poverty reduction: sustainable economic growth, macroeconomic stability, and democratic governance. *Specific requirements* refer to actions needed at the micro and meso level to promote social equity and directly assist the poor to become partners in growth and share in its benefits, by creating economic opportunities, fostering their human development, leaving them less vulnerable to negative shocks and social problems, and eliminating their political and social exclusion.

GENERAL REQUIREMENTS

Sustainable Economic Growth

A necessary condition for faster poverty reduction in Latin America and the Caribbean is a return to sustainable growth. The reform programs launched in the early 1990s speeded up growth in a number of countries in the region, albeit with mixed results. Deeper, "second generation" reforms would help propel growth, but ways must be found to ensure that growth benefits more disadvantaged population groups, generate an environmentally sustainable framework for growth, and reduce its vulnerability.

As noted above, the impact of growth on poverty reduction depends on the initial level of inequality and the pattern of growth. In order for the poor to participate and contribute more to growth, the direct and indirect links between economic growth and poverty reduction must be strengthened. This includes policies to increase the impact of growth on the generation of employment for the poor and specific activities designed to reduce the disparities in access to and the accumulation of assets by the poor and excluded and to increase returns on those assets. Evidence from recent studies shows that growth has a greater impact on poverty reduction when it includes geographic areas or sectors where the poor population is concentrated, and when the initial educational and infrastructure conditions are more favorable. Thus, there is a need for growth that will promote more balanced regional development. Moreover, through the increase in fiscal resources, growth can also help reduce poverty by promoting an increase in social spending targeted to the poor, particularly by way of programs designed to improve their assets and productivity.

At the same time, it is important to ensure that economic growth is environmentally sustainable in order to attain poverty reduction. The poor are disproportionately affected by

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

environmental degradation. The growth of urban agglomerations in the region is posing health risks caused by air pollution from vehicle emissions and industry, surface water and groundwater pollution, lack of access to safe water, and inadequate sanitation and solid waste management systems. These factors are associated with higher incidences of disease and death among the poor, and affect their quality of life. Furthermore, a large portion of the poor in rural areas depend on natural resources as their only asset for consumption and the generation of income, which frequently leads them to overexploit these resources, causing impoverishment and environmental degradation that jeopardizes sustainable development. It thus is important to develop ways to manage natural capital in an economical and sustainable manner, introducing specific measures to avoid environmental degradation (these issues will be addressed in detail in the Environment Strategy).

Macroeconomic Stability

Reducing growth volatility and inflation are necessary conditions for lowering poverty levels in the region. Over the past twenty years Latin America and the Caribbean have weathered a succession of macroeco-nomic crises, which (apart from wars and natural calamities) have been the chief cause of the surge in poverty. Such upheavals can severely curtail human capital accumulation, particularly in the poorest households, when family members become malnourished or have to cut short their schooling. Inflation also hurts the poor more than the upper income brackets, since their meager financial holdings are non-diversified and cash-heavy. Likewise, the poor are more likely to be dependent upon government cash transfers, subsidies, or pensions that are not adjusted for inflation.

The persistently high volatility and inflation levels in some countries in the region can be attributed in large measure to unsustainable fiscal and monetary policies and political instability. However, several countries that accompanied their sweeping structural reforms with responsible, sustainable fiscal and monetary policies were battered by severe macroeconomic crises, some of them set off by financial contagion. Action thus is needed to lessen the volatility of capital flows toward the emerging economies, such as measures to improve the international financial architecture, in coordination with other agencies. The countries, for their part, need sound monetary and fiscal policies that will be sustainable in the long run. These include: exchange-rate regimes suited to the structure of their economies; tax reforms; efficient public expenditure schemes; decentralization approaches that assure fiscal discipline; international regulatory standards for banks, other financial institutions and for large corporations; the development of domestic capital and equity markets; and moves to broaden and diversify countries' export base, with the aims of improving the competitiveness of the economy and the incentives to invest in productive activities; and reducing the variability of tax revenues among others. (The Sustainable Economic Growth Strategy covers these issues.) Countries need a combination of sound macroeconomic management and fiscal policies that give the State enough resources to adopt anti cyclical measures, and to help build economic and social infrastructure and make real inroads against poverty and inequality.

Democratic Governance

There is growing recognition of the fact that the consolidation of public institutions and political stability, key elements in what is known as governance, is indispensable for ensuring sustained growth accompanied by a reduction in poverty and inequity. To achieve this requires harmony and complementarity of the functions of the state, the market, and civil society. The state must assume a central

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

role in the ordering and functioning of the markets, to facilitate the development of the private sector as an engine for the modernization of economies and inclusion in the global economy, and must promote justice and social equity. For its part, civil society must play an enabling, active, and participatory role in the process of economic modernization and public administration.

Governance facilitates economic growth, empowers the poor, and helps directly to ensure that growth is broad and participatory. Although there are a number of definitions of the concept of governance, its general requirements include accountability, transparency, application, and respect for the law. The validity of governance requires that the state has the capacity to promote, articulate, and coordinate the participation of all social actors in democratic and transparent processes that define public policies. There are considerable differences in political systems both in the policy arena and in the avenues each system offers to ascertain and respond to public concerns. Generally speaking, however, representative democracies with broad-based public participation afford stronger assurances of accountability, transparency, and respect for the law than alternative systems such as authoritarianism. Representative democracy can thus help tip the scales in favor of the poor, while also making a general contribution to human development. These systems offer greater opportunities for systematic representation of the interests of the poor as public policy is developed and implemented. Thus the spread of representative democracy in recent decades has been an important development for poverty reduction in the region.

It is also essential that the formulation, adoption, execution, and evaluation of public policies take place in an institutionally solid environment, and that the principles of governance referenced above apply to sub-stantive processes to reduce poverty and promote social equity.

SPECIFIC REQUIREMENTS

Create Economic Opportunities for the Poor

Some of the reasons why market reforms have done little to reduce poverty are the poor's scant access to goods and services and financial markets, their meager asset base, and an unbalanced regional development, which limit the poor's potential to generate income. Insufficient access to assets is also a major reason for the low quality of life of millions of the region's poor, particularly in rural areas, who have no running water or sewer connections, electricity, and transportation infrastructure. The accelerated development of information technology affords important opportunities but also poses challenges for poverty reduction and increased equity in the region.

Action is needed on multiple fronts to give the poor better access to national and international goods and services markets, increase their productivity, and improve their quality of life: lowering transportation costs to and from remote or largely inaccessible areas; implementing programs to give the poor access to marketing networks and new telecommunications and Internet technologies; promoting investments in basic physical infrastructure (roads, electricity, water and sanitation, irrigation canals, etc.); and promoting stronger ties between the productive activities of the poor and the dynamic sectors of the economy.

International trade integration should bring about oportunities and direct net benefits to the population living in poverty. To this aim, the increase in access to world markets and foreign investment should take into account the abundant factors in the region (labor) and should be accompanied with mesures to strengthen the cooperative and export capacity of micro and small enterprises and rural producers, as well as support to the vulnerable population temporarily affected by job losses.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Efforts to give the poor easier access to production markets should also include measures to improve regulatory systems, particularly at the micro level and in the labor markets. This will mean, for instance, removing barriers to the formalization and growth of micro enterprises and small businesses, and promoting competitive pricing of basic utility services like power and water. In the present context following the privatization of many companies and utilities in the region, there is a need to ensure that low-income groups' access to basic services is not curtailed by their capacity to pay.

Although the insufficiency of incomes to emerge from poverty relates fundamentally to human capital insufficiency (an issue examined in the section on human development) and the lack of complementary assets (particularly capital and infrastructure), recent studies show that labor regulations are also keeping workers, especially the less educated, out of higher productivity jobs. To improve the access of these workers to better jobs, countries need policies that simultaneously lower recruitment and termination costs and help create more jobs. Necessary adjuncts to such policies are improvements in instruments for social protection and intermediation and employment training programs to help displaced workers find new jobs in dynamic sectors of the economy.

After a decade of reforms, most of which included deep liberalization of financial markets, the region still must find a way to give the poor better access to saving and credit markets. Some avenues to that end are micro finance programs, incentives for financial institutions to diversify their product and service offerings to reach out to low-income customers, improvements in loan security information systems, and products to lessen the risk exposure of the poor. In this context, alternative mechanisms must be explored for financing productive activities such as support for traditional land leasing practices, community work, and horizontal and vertical interchange of products and services in indigenous communities, and the use of emigrants' remittances for investment.

One of the priorities for poverty reduction should be augmenting the asset base of the low-income population. Over 40 percent of the rural poor have limited or no access to productive resources, including land, to generate sufficient income through their own agricultural production. These assets can be increased by improving property ownership rights and their family-based and individual use (particularly by women) and/or collective use (as in the case of many indigenous or Afro-descendant communities) and the legal security of real property, the promotion of access to land through cost-effective market mechanisms such as sustainable agrarian reform programs and land leasing, and programs to give the poor access to housing and financial saving products.

The high incidence of poverty in rural areas requires special emphasis on specific actions to increase opportunities for the poor in the rural sector and to promote a more balanced development in the region. Small producers account for the majority of the rural poor, followed by landless inhabitants and indigenous persons. A significant proportion of small-scale agricultural producers are smallholders with limited opportunities to emerge from poverty through agricultural development. Consequently, the fight against poverty in rural areas requires a set of specific actions to boost the productivity of small-scale farmers with agricultural potential (improvements in access to land and ownership rights, irrigation, research and technology transfer, development of rural financial markets, coordination with the market), and to generate employment and increase the incomes of small-scale farmers without agricultural potential and other rural inhabitants (development of land markets, rural micro enterprise, rural private investment in activities that add value to primary production, and training).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

The gender dimension is another key element in creating economic opportunities for the poor. Investing in women—in developing their capacities and improving their access to basic services and economic opportunities—will strengthen the effectiveness of investments in the physical and social infrastructure, as well as have a direct impact on women's welfare. In addition, economic resources, such as access to land and agricultural inputs or income from work, in the hands of mothers have a greater positive impact on family nutrition than resources and income in the hands of fathers. Thus, increasing the social and economic status of women will help enhance social equity and reduce poverty.

Environmental policies, for their part, need to include specific measures to alleviate the harm that environmental degradation does to vulnerable communities and to promote environmentally sustainable productive practices, including recovery and use of the traditional knowledge and practices of indigenous populations. To that end, there is a need to promote innovative approaches to the sustainable management of ecosystems that are the site of economic activity and home to poor populations such as indigenous communities and other marginalized ethnic groups (for example through sustainable crop practices, eco tourism, and the use of medicinal plants).

Human Development

Given that labor is the main productive factor of the poor, a critical element in the fight against poverty and inequality is the strengthening of human capital investments, from early childhood through adulthood. This has been reaffirmed by the Heads of State in their commitment to the Millennium Development Goals and in other regional summits.

There is solid empirical evidence indicating that education is a key area where public policy has the most potential on reducing poverty and inequality. Human skills and potential are developed largely in early childhood and are significantly affected by the learning environment in the home, school, and local community. The poor population's investment in education is limited because of insufficient savings, child labor, and/or because of credit market constraints. Returns to education in the region have been increasing greatly, reflecting, for one thing, the stronger demand for workers with post-secondary schooling. This has worsened inequality in labor income and also means that a poor family has to keep spending for its children's schooling beyond the basic secondary level to offset the loss of income and other costs associated with school attendance. The equity gaps in education go beyond access to education. Poor children have weaker academic performance because of the inferior quality of the education they receive at school and the low educational background of their parents, which affects what they learn at home. Indicators on repetition rates, pass rates, and the quality of education for the poor are substantially lower than the average for the population. Thus, students from poor families have a harder time finishing primary school, and their learning levels put them at a clear disadvantage to access and complete secondary school or go on to higher education. The inadequate quality of instruction, its limited relevance to the world of work, and its unsuitability to a culturally diverse population therefore represent core obstacles to the poor accruing any of the high returns of quality education or better employment opportunities, severely limiting the potential contribution of education to social mobility in many of the region's countries.

Good health also yields important benefits: a healthy workforce is a more productive one, fewer days are lost to illness and good health contributes to a higher standard of living. Poor nutrition during the fetal stage retards growth and increases the infant mortality. Since catch-up potential after age 2 is

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

limited, malnourished children have weaker cognitive skills that in turn, minimize their prospects for human capital accumulation and their productivity as adults. Poor households in which the mother or father dies, or family members are stricken with AIDS or other endemic diseases like malaria or tuberculosis are devastated by the loss of income and the high cost of medical care. Costs of private care, the poor's limited access to health centers—because of distance, cultural factors, a lack of information or some combination of these problems—and the substandard quality of public health services are fundamental constraints for poor families' investment in health.

All these factors make for sub optimal education and health investment and hence low human capital accumulation in countries with high poverty and inequality levels. This contributes to the intergenerational transmission of poverty and inequality.

Public spending on health and education has had only a limited impact on improving this state of affairs. Though public spending increased in the 1990s and is moderately progressive in most of the countries, it has not realized its entire potential due to inefficiencies in its allocation and use. No significant changes have been made in the mechanisms for financing social spending with regard to the need to link such spending to indicators of the quantity and quality of the services provided. Progress in the design of systems to transfer resources that promote greater equity (based on poverty indicators, for example) has been limited. Administrative decentralization of spending at the local level has not been accompanied by greater autonomy in fiscal revenues and in local and participatory management of the delivery of social services. In some countries, higher-education subsidies are still being appropriated preponderantly by better-off families. Health spending is still too heavily concentrated in medical treatment and hospital care rather than on more preventive interventions that are more cost-effective and benefit the poor above all. A large proportion of budgets still goes to personnel, with weak performance levels, and there continues to be severe shortages of basic materials needed to operate and maintain schools and health centers.

For all of these reasons, improved management of public social spending and in the supply of quality education and health services should be a chief priority on social policy and reform agendas. It is essential that social policies and programs go beyond achieving universal access and include the goals of equity and quality in education and health, especially for the poor. This approach will mean combining comprehensive programs to improve the coverage and quality of the supply of education and health services; policies and systems designed to improve equity, efficiency, and effectiveness in social spending, and programs to promote demand and investment in these services on the part of the poor. Recent experience and the evaluation results of programs that tie cash grants to household's use of health and basic education services (for instance, the Progresa Program in Mexico, Bolsa Escola and Bolsa Alimentacão in Brazil, PRAF in Honduras and the Red de Protección Social in Nicaragua) shows them to be an effective way of easing poor families' financial constraints and encouraging them to invest in human capital. Thus, these programs should be a key element in the alleviation and fight against structural poverty and inequality. One way to make human development programs more effective is to create linkages needed for successful transitioning from one life-course stage to another—for instance, between infancy and childhood, primary and secondary education, school and the workplace. Early intervention and prevention are priorities here, as are actions to exploit natural synergies among sectors.

Recent experience shows that actions specifically oriented toward promoting women's development and empowerment are

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

key to poverty reduction. The education of the mother is vital in order for the children to achieve adequate levels of nutrition and education, improve health for the whole family, and is associated with a decrease in fertility rates in the region. Accordingly, addressing the demand for reproductive health services and actions to increase the educational level of the children, adolescents, and women of childbearing age are important factors in breaking the intergenerational transmission of poverty and reducing infant and maternal mortality. Actions are also necessary to facilitate the involvement of women in the work force, including training and the establishment of childcare centers. Women must also have a preponderant role in the implementation of programs to fight poverty. For example, programs in which monetary transfers are conditional upon the demand for education and basic health are more effective when channeled through women in households.

Social Protection and Prevention

One of the stiffest obstacles to poverty reduction in the region is the poor's excessive exposure to risk. The poor have no shield against idiosyncratic shocks in their personal lives such as illness, unemployment, or poor harvests or against systemic risks like economic crises, epidemics and natural disasters. There are several reasons for their vulnerability: (i) few of the poor have access to social security plans (since they do not belong to any contributory system either because their employers will not cover them or by virtue of legal or de facto restrictions) or private insurance, and they have difficulty borrowing because of problems of adverse selection and moral hazard; (ii) they have little capacity for precautionary saving and the opportunity costs of such savings are high; and (iii) they are more or less powerless to promote government-funded programs targeted to the poor or social safety nets during episodes of fiscal adjustment.

The region needs to redouble efforts to develop sound institutional responses to cushion the impact of adverse shocks on the poor. Social-protection policy interventions can improve the welfare of poor people faced with sharp drops in income or consumption and possible erosion of human capital investment. Apart from these equity improvements, social protection for the poor can spur growth in so far they can afford to take riskier, but with higher returns, activities in the production sphere and labor market. Lastly, if the poor are shielded from income fluctuations associated with the lowering of trade barriers and flexible labor markets they will be more likely to back liberalization programs and pro-growth reforms.

In order to improve social protection systems so as to guard from aggregate risks like economic crises, countries should promote actions to reduce economic volatility, make social spending more counter cyclical, and strengthen social safety nets for times of upheaval. The vulnerability from the threat of natural catastrophes can be eased both ex ante and ex post through programs to institute early warning and information systems about adverse weather events, build basic infrastructure to mitigate the effects of disasters, resettle communities living in risk-prone areas, enhance the disaster response capacity of State institutions, and promote financial instruments to fund post-disaster construction projects. Initiatives that can leave the poor less vulnerable to idiosyncratic shocks include preventive health programs, programs to extend social security and social assistance (particularly for the disabled and elderly living in poverty) and health insurance coverage through public and/or private plans, individually funded retirement plans, minimum pensions for the low-income population, and emergency employment programs that especially include the most vulnerable groups, such as women and youth.

Another dimension of poverty in the region is the vulnerability of the poor to

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

crime, social and domestic violence, unwanted youth pregnancy, child labor, the issue of street children, alcoholism, substance abuse, and other social ills. There is evidence that these social ills take a disproportionate toll on the physical, human, social and cultural capital of low-income groups. In several major Latin American cities, for instance, the poor and the disadvantaged are disproportionately the victims of violence and certain types of crime. Women who are victims of domestic violence see their income plummet and their children's school performance suffers. Crime and social violence in general cloud the business climate and investment prospects (including human capital investment) and dim prospects for employment and income increases in communities. Unwanted youth pregnancy is associated with a dramatic deterioration in young mothers' socioeconomic status.

Measures are needed, especially of a preventive nature, to reduce the incidence of crime, violence, and other social ills in low-income groups, by improving access to law enforcement, information, counseling, programs for at-risk children and youth, and policies fostering peaceable coexistence and integration on a local, national, and regional scale.

Political and Social Inclusion

An effort on multiple fronts is needed in countries' institutional apparatus to achieve more accountable, transparent and rule-of-law political systems with a greater capacity to reduce poverty and inequality. The workings of government need to be revamped so public agencies can better meet the needs of the poor and to ensure more accountability. For one thing, public service delivery is frequently skewed toward the upper income brackets. Another vital set of initiatives has to do with the participation of the poor in decentralization processes in the region. Political systems with a tradition of centralized authority need mechanisms to demand more accountability from local authorities as well as to assure genuine political participation at the local level. There is a pressing need to make the region's legal and justice systems more accessible to the poor. Poor people are more likely to be victims of certain crimes and human rights violations but have virtually no legal recourse to do anything about this. A restructuring of judicial processes with an eye to assisting the poor should be on State reform agendas throughout Latin America.

Another way to make meaningful improvements in the lives of the poor is to remove societal barriers to their participation and to help build social capital at the local and national levels. Substantive changes in laws and institutions are needed to help include excluded groups, including the strengthening of government institutions responsible for developing and overseeing regulations with respect to minority ethnic groups and the coordination of indigenous legal systems and customary rights with national laws and jurisprudence. Social capital can go a long way toward reducing poverty, but active support from government institutions is frequently needed for social capital formation. One essential condition here is an enabling climate and regulatory environment to promote genuine participation of community organizations of the poor.

Reforms of key political institutions in the region could pave the way for much broader participation by the poor and make sure that their interests are duly represented as public policies take shape. Modernizing Latin American legislatures could be a force for poverty reduction and social equity promotion. Electoral system reform could help put serving the needs of the poor, more notably on the agendas of parties.

Poverty and inequality in the region have historic, geographic, ethnic, racial and gender roots. Social exclusion is rooted in unequal regional development, the uneven opportunities of human development, the uneven dis-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

tribution of factors of production, unequal access to credit, and lower returns on productive activity of excluded groups, frequently due to discrimination. For instance, the inferior school quality that reduces returns to education and the gap in access to higher education between the excluded segments of the population and the rest of it limit the accumulation of human capital in such segments. Discrimination in returns to physical and human capital also removes incentives for their accumulation. Residential segregation can saddle the poor with low levels of human capital stemming from under funded schools in poor communities, squandered group learning externalities, and a dearth of mentors or role models. Experiences with slum renewal and neighborhood upgrading and indigenous and Afro-descendant community development programs show what can be accomplished by integrated interventions and by addressing cultural facets of development especially with regards to making programs and the institutions responsible for them sensitive to culture. Accordingly, comprehensive interventions to break the intergenerational transmission of poverty and inequality among excluded groups are key for poverty reduction.

RECENT BANK ACTION

In recent years a considerable share of the Bank's lending and non financial products have been directed toward poverty reduction and equity promotion, in pursuit of the Eighth Replenishment indicative lending targets. Social equity enhancing (SEQ) loan approvals between 1994 and 2001 accounted for 44.6 percent of overall lending in volume terms, exceeding the 40 percent cumulative target. In terms of number operations, over that same interval, SEQ loans made up 46.2 percent of total approvals, still short of the 50 percent cumulative target. But the percentages are trending up: between 1994 and 1998, SEQ loan approvals accounted for 41 percent and 42.4 percent of total lending by volume and number of operations, respectively, fulfilling only the indicative target for volume; between 1999 and 2001 the respective figures rose to 51 percent and 51.9 percent of total lending, surpassing both targets. Meanwhile, poverty targeted investment (PTI) lending in recent years has accounted for over 30 percent of the total by volume and over 40 percent by number of operations. The Multilateral Investment Fund (MIF), for its part, has devoted a sizable share of its resources to projects in the areas of microenterprise, microfinance, youth employment training, and migrant remittances, with important benefits to poor populations. Other IDB Group lending products, such as Inter-American Investment Corporation (IIC) operations to foster the development of small and mid-sized businesses in the region, contributed indirectly to poverty reduction in the region. For the most part, the benefits of social sector operations have accrued preponderantly to the poor. Nevertheless, for the Bank to heighten its contribution to poverty reduction, nonsocial sector operations should more directly benefit the poor, particularly in the areas of infrastructure, productive sectors and modernization of the State.

Recent years have seen an improvement in the use of targeting systems in poverty reduction projects, chiefly in the social sectors, thanks to a combination of factors: the more detailed data now available to be able to locate groups living in poverty and develop projects to benefit them directly; the use of in-house operating guidelines for these purposes; growing expertise in poverty issues in the operations departments; and the advisory role of the central departments. However, support is needed for countries to make greater use of beneficiary identification systems, in order for social and poverty reduction programs to be more effective. It is also necessary to deepen the lessons learned from the design and targeting of projects, with greater use of a rigor-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ous assessment of their poverty impact. There needs to be heavier emphasis on project impact monitoring and evaluation to more accurately gauge the Bank's contribution to poverty reduction. The most frequent difficulties in the implementation of SEQ/PTI operations are mainly associated with the fact that most of the projects are in the social sectors. The relative difficulty of implementing social projects can be explained by the vulnerability of local counterpart financial resources to economic crises and fiscal adjustments and the institutional weakness of local executing agencies. The main measures to address these issues include: promoting mechanisms to protect social spending during periods of crisis or fiscal adjustment; and, increasing technical capacity and the institutional importance of the social sectors in national government agencies.

The Bank has played an important role in enlarging the body of information available for poverty assessments, analyses and the design of targeted projects. A key achievement in this respect is the improvement of household surveys, promoted through the Program for Improvement of Surveys and Measurement of Living Conditions in Latin America and the Caribbean (MECOVI). Bank's support to this program will continue to play an important role in its future implementation.

On the other hand, in recent years the Bank has supported the preparation and implementation of national poverty reduction strategies (PRS) in the framework of the Heavily Indebted Poor Countries Initiative, and has begun to support strategy preparation in other countries. Consequently, the Bank will strengthen this strategic support to the countries for the development of comprehensive poverty reduction strategies, building that objective explicitly into its programming process, policy dialogues and country strategy development. This is important since in some cases, the Bank's support for poverty reduction has been confined to individual operations, not necessarily with a comprehensive country-specific poverty reduction strategy focus. Supporting the countries in the formulation of comprehensive strategies for poverty reduction has therefore been identified as a priority area of activity for the Bank.

Since 1997, Bank action for poverty reduction has been guided by the Poverty Reduction Strategy approved that year. The strategy emphasized that economic growth was a necessary factor but was not sufficient to reduce poverty and that specific actions for the poor were needed. The strategy stated that human capital formation was key to reduce poverty and included other important aspects that are central to the fight against poverty. In addition to the areas of activity proposed in that strategy, based on experience over the past few years, the strategy proposed herein includes the following core elements to guide future Bank action for poverty reduction: multidimensional, comprehensive assessment of poverty; greater emphasis on the issue of equity and its relationship to the low impact of growth on poverty reduction; a more comprehensive treatment of social protection mechanisms and the dimensions of gender and social exclusion by race and ethnicity; stronger focus on the institutional capacity of the State to finance, design, and prepare poverty reduction programs; a comprehensive strategic approach to poverty reduction, promoting poverty reduction strategies in the borrowing countries; greater emphasis on Bank programming to fully integrate poverty reduction into its activities; consistent, explicit linkage with other core strategies for Bank action in its priority areas of activity (competitiveness; social development, modernization of the State, regional integration and environment) and efforts to monitor and evaluate progress in poverty reduction.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

AREAS FOR BANK ACTION



Consistent with the Eighth Replenishment recommendations, and taking into account the above-described diagnostic and lessons learned, this section proposes the areas for Bank action to reduce poverty and enhance social equity.

This objective will be achieved by assigning priority to: (i) policies for sustainable economic growth and macroeconomic stability as the prerequisites for reducing poverty and inequity (issues addressed in the Sustainable Economic Growth Strategy); and (ii) support for *comprehensive poverty reduction strategies* that promote consistency in the various efforts. The strategy will also address the needs mentioned in the section above through selective support for initiatives for poverty reduction and equity promotion in the Bank's four priority areas. Specifically, the Bank will promote the creation of economic opportunities for the poor by supporting (iii) productive inclusion of the poor in production through investment for *Competitiveness*; and (iv) productive inclusion by means of access to regional markets through *Regional Integration*. The Bank will also provide support for (v) initiatives to promote human development, social capital, prevention of social ills, and social inclusion for the poor through *Social Development*; and (vi) activities to promote democratic governance and political participation of the poor through *Modernization of the State*. The Bank will also assist countries in the region to (vii) strengthen *multi sector social protection systems* to reduce the vulnerability of the poor. The cause-effect relation-ship between poverty and the environment is recognized in all these actions. Thus, the environmental factors that affect directly the means and quality of life of the poor will be handle transversally, in both urban and rural areas. The Environment Strategy recognizes these relationships explicitly.

The strategy presented here lays out general guidelines for the design of instruments to pursue the above areas of action. Since there are considerable differences in the face of poverty from one country to another in the region, the Bank's selective support under the country strategies should be tailored to country-specific priorities, developed through careful diagnosis of the causes of poverty and inequality, and making use of the Bank's comparative advantages. Table 1 in the Annex, summarizes the actions described below.

COMPREHENSIVE POVERTY REDUCTION STRATEGIES

The multidimensional nature of poverty requires a wide array of policies and programs on the economic and social front that address its multiple causes and manifestations. It is important to assure that all the programs and actions are articulated in a cohesive package to avoid the waste of resources, duplications or even incompatibilities across programs.

Thus, the Bank will provide special support to the region's countries to develop and implement their comprehensive poverty reduction strategies in a participatory framework. Such strategies should include a thorough analysis of the chief determinants of poverty and the ensuing clearly-defined priorities, developed with a long-term view in each country context; the selection of quantifiable,

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

realistic poverty reduction goals based on the Millennium Development Goals and other regional commitments; an action plan for pursing these strategies that considers coordination among international financial institutions and donor organizations in funding specific projects and programs; and a mechanism for supervising and assessing program and project impacts.

The Bank will support the improvement and implementation of national strategies in the countries that already have them, based on the guidelines specified in this strategy paper, and will promote their development in countries where no significant progress has yet been made. With respect to middle-income countries, the Bank will be selective in terms of emphasizing support for regional and/or sector strategies, with a comprehensive focus that addresses geographical areas with a greater incidence of poverty, and their principal determinants. The Bank's support for poverty reduction strategies will emphasize crosscutting initiatives in social and nonsocial sectors, with priorities defined in the four areas of comparative advantage of the institutional strategy and the development of comprehensive social protection systems. All these actions should be environmentally and fiscally sustainable and take gender and ethnic considerations into account.

ACTIVITIES IN THE SECTORS FOR BANK ACTION

It should be noted that although the Bank's contribution in the four priority sector areas may be important for the countries' progress toward attaining their goals to reduce poverty and social inequity, its capacity for action will always be insufficient to address all the needs of the countries. Thus, the Bank will favor financial support for actions that contribute directly to strengthening the productivity and the income generation potential of the poor and excluded groups, including the expansion of physical and social infrastructure and the development of their human capital. Additionally, the Bank will emphasize strengthening of the State's capacity to implement policies and programs for poverty reduction and social inclusion, evaluate the activities carried out, and apply the lessons learned during implementation of the programs.

Competitiveness

Poverty reduction in Latin American and Caribbean countries will require combined actions that address the need to improve the overall competitiveness climate (topic included in the Sustainable Growth Strategy) with measures to tackle constraints to the productivity of the poorest workers and small producing units. The pressing actions needed to increase overall competitiveness include: improving access to credit and capital markets; access to human resources, training, and labor relations; the availability of infrastructure (roads, ports, energy and telecommunications, etc.); access, assimilation, and generation of knowledge and new technologies; the quality of Government institutions related to the functioning of private productive activities, and the productive and sustainable administration of natural capital. Below we present the actions targeted to the poor, which are the subject of this Poverty Reduction Strategy, and which include initiatives to increase their asset base, productive capacities, and their access to labor and financial markets and goods and services.

Financial markets for small producers and poor workers. Lending to small producers and micro entrepreneurs is an unattractive proposition for most traditional financial institutions largely because such loans are expensive to administer and track. To give easier access to credit and other financial services to small producers, who bring together a significant proportion of the poor population, the Bank,

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

in cooperation with regional and national banking supervision organizations, will support programs that improve and expand short-, medium-, and long-term access to financial services for these groups; support the expansion and improvement of the services of micro finance institutions for micro entrepreneurs and small-scale producers; strengthen legal and regulatory frameworks governing micro finance organizations adapting them to incentives and market risks; develop a credit registry system; identify and disseminate best practices in the micro finance sector; develop financial alternatives for indigenous groups, and advise governments to design and implement policies that promote access to financial services, including channeling remittances from immigrants, for micro entrepreneurs and small-scale producers.

Property rights of the poor. According to the evidence, the poor could possess significant capital in some cases, but its productivity is limited because laws and institutions do not help protect or recognize individual or collective property rights. Thus, the poor can seldom use their capital as loan collateral or as transactional assets. The Bank can help alleviate this problem through programs designed to: clarify real property rights, especially in rural and marginal urban areas; rewrite land-use laws, removing current legal barriers to transactions in land, real estate and urban construction; and afford enduring legal certainty of ownership by linking modern cadastre systems with decentralized, moveable and real property registers that do not discourage the registration of transactions in marginal areas. The Bank will also support actions to strengthen indigenous management or co-management of their territories and (in cases where the land cannot be used as a guarantee) to explore the possible use of guarantee funds, joint ventures, and other financial facilities, including strengthening traditional systems of mutual self-help and redistribution to invest in productive activities that are socially and culturally appropriate.

Improvement of employment opportunities for poor workers. An efficient labor market is crucial in opening up more opportunities for the poor through gainful employment, particularly for workers with little education and within the informal sector. To this end, the Bank will support actions to raise the level of training of poor workers; modernize the contents of training programs to adapt them to the needs of the productive sectors; develop training programs tailored to the conditions and needs of micro and small enterprises and independent producers; improve labor market regulatory frameworks aiming at removing elements that are keeping low educated workers out of the employment mainstream; promote technical assistance programs for the labor authority to improve the adoption and enforcement of internationally accepted core labor standards; improve job placement and employment assistance systems to make them more effective and improve training systems through private provision of supply and strengthening of public regulation.

Promoting inclusion through basic infrastructure services for the poor. Since most of the factors of production are complementary, the labor productivity of the poor can be improved substantially if they gain better access to basic infrastructure such as running water, electricity, transportation or telecommunications service. The Bank will promote programs to: give low-income groups access to basic utilities and concurrently take steps to ensure that such services (particularly electricity and water service) will be sustainable; foster the adoption of appropriate power generation and telecommunications technologies in rural areas where conventional technology would not be efficient; promote local management of basic infrastructure and transportation system programs; and adapt the identification, design, and maintenance of

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

small infrastructure works in ethnic areas to local culture. Whenever the provision for a basic service has been privatized, the Bank will factor in the need to ensure that the access of the low-income stratum is not limited by the lack of capacity to pay or due to residence in remote regions.

In some countries of the region targeted and participatory instruments such as social investment funds may be effective for providing basic infrastructure to marginal communities with a high incidence of poverty, to the extent that they are framed within comprehensive poverty reduction strategies that are fully incorporated in the structure of the State and contribute to the process of strengthening local capacity and decentralization of the State. Use of these instruments should include activities to ensure their sustainability over time and monitoring and evaluation of their effectiveness and impact.

Access to science and technology for the poor. The Bank will also support the diffusion of new technologies to ensure access of small enterprises and rural producers to technological information and technical assistance; cooperation in research and development among enterprises and technical institutions; the development and diffusion of quality standards for products and; strengthening of the capacity to identify, generate and adopt environmental sustainable technological innovations suitable to rural activities; the expansion of the Internet infrastructure through phone cabins, rural telephone centers or community information centers; training in the use of these new technologies by small enterprises owners and small rural producers. The Bank will also support pilot programs and innovative efforts aim to develop new technology applications that benefit the poor, especially in information technology.

Cooperation between the public and private sectors to increase the competitiveness of the poor. The Bank will support the development of associative efforts among enterprises of different sizes and sectors, among them universities and the public sector. The associative capacity among micro-entrepreneurs, small entrepreneurs, and small rural producers will be strengthened to help promote local integral and participative programs. The Bank will also encourage the support to clusters and the strengthening of productive chains.

Other specific actions to support rural development. The actions described above to improve competitiveness will have a positive impact on the productivity of rural workers. These actions are very important, given the high incidence of poverty and low levels of competitiveness in the rural areas. On the other hand, the specific conditions of the rural sector require additional Bank emphasis on: Access to land through cost effective mechanisms; development and promotion of agricultural exports; strengthening of the management capacity of the small and medium scale agro entreprenuerial sector; and actions for the rational use of natural resources, particularly water (comprehensive watershed management, rehabilitation and improvement in the operation and administration of irrigation systems).

Other specific actions to support micro enterprise. Similarly as in the case of the rural sector, the actions described above to improve competitiveness will have a positive impact in the productive capacity of micro enterprises, which employ a high percentage of poor workers. To take advantage of the specific opportunities to increase micro enterprise sector productivity the Bank will place additional emphasis on: facilitate the technical knowledge and information that will make it possible for micro enterprises to increase their productive capacity, competitiveness, and access to markets for their products and services; provide business development services to micro entrepreneurs (including training, technical assistance, commercialization and

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

marketing); improve information systems on the input supplier market, local and international market trends, consumers, among others; provide access to technology and an increase in innovative capacity; promote clusters, networks, and subcontracting chains in order to take advantage of economies of scale in the procurement of inputs, mass production, and the provision of finished products; and promote cost reducing interventions

From the environmental perspective, the importance of creating competitive conditions between poor sectors that depend on the management of their natural resources or the environmental services available in their territories is highlighted. In this sense, the Bank will promote the creation of optimal conditions for the increase of income generating opportunities and increase in productivity on the basis of sustainable natural resources in marginalized, rural and indigenous communities.

Social Development

In keeping with its track record and recognized leadership in the social sectors the Bank has identified new areas and approaches on Social Development with the goal of promoting equity and expanding the benefits of the social portfolio for the poor tackling the region's current demographic and social challenges. This includes policies, programs, and initiatives that emphasize human capital development in the education and health spheres, enhance the quality of life of the poor through housing interventions; ensure effective transitions along the life cycle; end social exclusion and strengthen the countries' capacity to prevent the proliferation of social ills that take a disproportionate toll on the poor; and support integral interventions for low income populations in circumscribed territories. Specifically, the Bank will address the needs of the poor and the excluded through actions in the following areas of social development:

Reduction in the inequality in access to education, health and housing services. The Bank will put central emphasis on programs that address the challenges embodied in the Millennium Development Goals and other global and regional summit commitments. The Bank will continue to complement its core support for basic education and health infrastructure with sector operations supporting institutional reforms and innovative approaches to health care and education delivery, at adequate standards of quality, in poor communities, and with targeted human development programs that offer subsidies tied to demand for these services. The education and health reforms should strengthen management of the system and efficiency in spending according to equity standards; and promote financing mechanisms and incentives linked to performance thereby promoting interagency coordination, evaluation capacity, and ongoing dialogue with key stakeholders, including the very poor and excluded.

In education, the Bank will support actions that, based on the major achievements in universal enrollment at the primary level, will improve its quality and gradually expand access of the poor to quality secondary education. These activities will seek to improve the efficiency and equity of education systems in order to guarantee learning and development of the skills necessary for poor children and youths to become active citizens and to participate effectively in economic development. Support will be provided for direct interventions, targeted on low income families and areas, to improve primary and secondary school instruction and learning and to help increase access to post-secondary education, such as updating and adapting curricula to the needs of a changing labor market with greater cultural diversity and the participation of women and the disabled. The Bank will support comprehensive and targeted investment programs centered on schools to pro-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

vide the material, financial, and human resources necessary to guarantee the conditions to effectively implement the curricular reform; empower teachers as responsible agents for student learning and principals as responsible managers for academic performance in the schools; improve teaching conditions and hours of instruction in the schools; and promote proper systems for monitoring learning and teaching practices in the classroom. Modern information and telecommunications technology resources can also be tapped for this purpose, to bring access to good-quality education (for example through distance learning approaches, including television-assisted secondary education programs) and promote training specifically on the use of such technologies in isolated schools in poor communities. The Bank will also support programs for multicultural bilingual education for indigenous communities.

In order to achieve the Millennium Development Goals in *health*, reduce the gap faced by low-income populations, and in particular, reverse the leveling off in the reduction in the existing high levels of child and maternal morbidity and mortality, the Bank will place a renewed emphasis in quality primary health care and effective public health services. Health reforms should strengthen the systems for organization and financing of services; linking them to specific country needs and goals; reorganizing highly complex ones; promoting cultural adjustment for indigenous groups; and developing new types of care in areas with little State presence. Based on the epidemiological profile of each country the Bank will support actions to ensure consistently high basic vaccination levels; effective implementation of the Comprehensive Strategy for Childhood Diseases in association with other international development agencies; and mass information, education, and outreach campaigns on health for vulnerable groups. The Bank will also support activities in the area of environmental health, which has a major impact on certain transmissible diseases, by providing financing to projects for basic sanitation and the access to safe drinking water, an issue that was assigned high priority at the Johannesburg Summit, and related activities. In addition, the Bank will strengthen its support for reducing maternal morbidity and mortality, which mainly affects poor women, through continued financing for reproductive health, basic obstetric care, and related activities, in order to reduce the economic, cultural, and geographic barriers to health care services. The Bank will also continue to emphasize the decentralization of health services; development of community health systems; and prevention and treatment of transmissible diseases such as HIV/AIDS, tuberculosis, malaria, and dengue, and other diseases that disproportionately affect the poor.

The Bank will support actions that promote the important role of women and the fight against poverty. Greater emphasis will be put on health and nutrition specifically through early intervention programs, such as prenatal care for pregnant women, child nutrition, and preschool childcare.

The Bank's action in *housing* will continue to support governments to expedite the functioning of housing market and to target public spending in lower income households. The Bank will support strengthening of the regulatory capacity of state institutions and promote the conditions for the private sector to take over housing construction and financing. The Bank will support reforms in the housing sector to promote private financing and construction for housing for the poorest populations and increase the availability of land authorized for residential usage at affordable prices for the poorest households. The Bank will also support programs to expand direct access to housing solutions for low-income households. In order to improve the quality of the existing housing stock, the

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Bank will promote programs to provide financial and technical support for gradual improvement of housing.

Equal opportunity during the life-cycle. The poor and the excluded may be ill-served by physical and human capital development programs that fail to create the linkages needed to successfully manage the transition between different life-course stages—from infancy to childhood, primary to secondary school, school to the workplace, and the workplace to retirement. Interventions to improve the health and education of the poor will not be truly effective or sustainable unless they address those crucial transitions, understand the importance of early intervention and prevention, and exploit natural cross-sector synergies. The Bank will support programs to help the poor navigate these critical life-cycle transitions, with particular attention to synergies within the health sector (for instance, combining reproductive health programs, pediatric services and programs to combat malnutrition); between health and education (e.g. comprehensive programs providing services for families, preschoolers and infants); between school or university and the workplace, and between jobs, especially taking into account women's transition into the labor force (for instance through early interventions to assist young people from poor families, and childcare centers).

Elimination of social exclusion and other social ills. The Bank will supplement the activities to create opportunities and promote social development for the poor with social inclusion initiatives and programs that ensure that benefits reach groups that have found themselves excluded by reason of gender, ethnicity or race, disability or AIDS. This includes building capacity in national statistics bureaus to gather data on social problems and excluded population groups. In addition, the Bank will include specific actions in operations to expand the asset base, create market opportunities and strengthen public management so as to expand their benefits for excluded groups and geographic areas, and will support the development and enforcement of anti-discrimination legislation and social campaigns in collaboration with the private sector. It will support country initiatives to eliminate the stigma and discrimination against persons with disabilities or AIDS.

The Bank will foster initiatives to prevent crime, violence and other social scourges. Specifically, it will support institutions responsible for programs to curtail child labor and address the issue of street children, domestic violence prevention initiatives, community violence-prevention actions, social promotion and public education campaigns and education advocating peaceable coexistence, substance and alcohol abuse prevention, treatment and rehabilitation for young people, and prevention of unwanted youth pregnancy.

Support to the integral development of circumscribe territories as key elements for poverty reduction (e.g. municipalities, indigenous territories, autonomous regions). The Bank will continue to support comprehensive programs in circumscribed territories that tackle the roots of poverty and exclusion, and promote balanced regional and local development, with a participatory focus. This would include slum renewal and neighborhood upgrading programs offering a package of services to improve living and environmental conditions and give the urban poor more opportunities; policies to reduce residential segregation and support economic, social, and physical rehabilitation of deteriorated cities; and sustainable local development programs for indigenous and Afro-descendant communities to augment their physical, cultural and social capital.

Social development actions with positive impact in the enviroment will be promoted by the Bank to attack the roots of environmental degrada-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

tion processes that affect the quality of life of the poorest populations (elimination of solid waste, polluted water, air pollution inside and outside homes, soil degradation, etc). Bank action will contribute to better life opportunities and less vulnerability to environmental risk for these low income populations.

Modernization of the State

One condition for poverty reduction is a democratic, effective and efficient State that is responsive to the needs and aspirations of the poor and excluded, is accountable to them, and gives them a voice and influence in institutions of governance and access to economic opportunities. Therefore, the following priority areas for Bank activity in the area of Modernization of the State geared towards the reduction of poverty and promotion of social equity have been identified:

Democratic system and social inclusion of the poor. The Bank will strengthen actions to promote the political inclusion of the poor. Actions will be taken in the following areas: Strengthen the structure and institutional capacity of the legislative branch in order to facilitate the voice and effective participation of excluded groups; modernize electoral system in order to ensure equal opportunities to all citizens; strengthen the capacity of institutions of control and supervision to assure greater transparency in public management and avoid discrimination; support decentralization processes that allow the integration of marginal sectors and involve the affected groups in decision processes; strengthening the capacity of community organizations of the poor, vulnerable groups and/or traditional excluded groups, and their connection with decentralization processes; and foster values of democratic inclusion in society at large.

Rule of law and access to justice of the poor. For the consolidation of the rule of law in the countries of the region, the Bank will step up its support for the broadening and consolidation of the institutional reforms needed to make sure that all citizens possess and can effectively exercise their fundamental rights, including recognition of the rights of indigenous and other ethnic groups. In this context, the Bank will support programs to widen the access of the poor to justice. Bank efforts will include modernization of justice procedures to diminish barriers and costs of access, including the simplification of norms; promotion of alternative mechanisms for conflict resolution, including local judges; and promotion of access of the poor to people and assets registries. To strengthen the rule of law, the Bank will support programs to address the institutional weaknesses that foster corruption, especially those that negatively affect the income and access to basic judicial services for the poor, as well as programs to foster citizen security and reduce the exposure of the poor and excluded population to violence.

State, market and equity. The development of efficient and inclusive markets requires actions to remove obstacles that dissable the poor population and excluded groups to effectively access market opportunities. To that end, the Bank will support institutions that broaden the opportunities for excluded sectors and regions. The Bank will also support actions to facilitate the legal incorporation of informal economic activities, particularly those of small and micro-enterprises, and simplify the enforcement of contractual obligations; promote social regulation of basic services that ensures the rights of the poor and citizens that are excluded from these services; and support the development of instruments that facilitate the adequate represention of the interests of low-income consumers and those affected by the reforms , in the process of public policy formulation.

Public management for equity. The Bank will support an integral management of the cycle

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

of policies that emphazises the prioritization of resources for poverty reduction and the promotion of social equity, the institutionalization of the poverty reduction policies, an efficient social public expenditure management through accountable and service oriented institutions, and the development of the fiscal capacity of the State to ensure investments that contribute to poverty reduction. Particularly, the Bank will support the development of capacity to coordinate and formulate state policies for poverty reduction, including targeting of programs and participation of relevant social actors; transparency in management of resources; budget resources allocation systems that promote equity (for instance, based on poverty indicators) and efficiency (for instance, linking expenditures to the quantity and quality of services); streamlining public institutions through the establishment of a merit based civil service and management capacity building; modernization of public services management, incorporating the participation of beneficiaries through community organizations; administrative descentralization of expenditure management, with strengthening of the institutions that coordinate multisectoral actions in disavantaged regions; and the use of new technologies to improve access of poor and marginal populations to public services.

Due to the fact that attacking the environmental problems that affect the poorest populations requires *the improvement of environmental governance* among local communities, the Bank will promote the creation of capabilities for local environmental management and effective community participation mechanisms for the decision-making process regarding natural resources. Likewise, the Bank will support the development of instruments that allow local government and communities to take directly decisions on the management of the resources. All these aim to create mechanisms of environmental governability that empower local communities, indigenous groups and in general all deprived groups in the process of environmental decision-making.

Regional Integration

Regional integration affords the member countries secure, rule-based market access and preferential free trade. At the recent Conference on Financing for Development in Monterrey, Mexico, the importance of increasing the access of exports from developing countries to all markets was acknowledged. In this sense, the Bank addresses different actions with regard to regional integration to accelerate subregional, as well as panamerican and interregional integration and to maximize the benefits of such integration on the well being of the population in general and of the poor and excluded. These include:

Consolidation of the positive effects of regional markets on the welfare of the poor. The Bank will support programs that promote the consolidation of regional markets taking into account the economic inclusion to the poorest and boosting the positive impacts of regional trade on these populations. These programs will put emphasis on increasing access to global markets through activities in which comparative advantages exist; promoting investments that increase opportunities and direct benefits to marginalized populations; promoting the dynamic transformation effects of the integration process while attempting to minimize the deviation of trade and loss of employment; consolidating the positive effects that regional markets have on modernization of technology, taking into consideration the abundant factors in the region (labor); and addressing the negative effects of integration on income disparities. Finally, the actions to be undertaken in this area will consider the establishment of national support mechanisms for the most vulnerable populations affected temporarily by the integration process. Special

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

attention will be rendered to communities located in vulnerable border areas, such as those with indigenous inhabitants.

Developing regional infrastructure. The Bank will continue its support for regional infrastructure. Projects designed to link urban or industrial poles by way of infrastructure corridors may have a significant social impact because they may traverse other less developed areas, whose residents thereby gain new communication resources and opportunities of progress. Support for regional infrastructure expansion will center on establishing development corridors, such as the South American Regional Infrastructure Integration Initiative (IIRSA) and the Puebla-Panama Plan. A number of sub regional integration groups also have launched border integration initiatives that are benefiting marginalized populations in those areas.

Institutional strengthening for integration. The Bank will promote the institutional strengthening of the organizations that are entrusted with the negotiation of integration agreements and the regulation of international trade with the objective of having an adequate institutional framework to facilitate a balanced and inclusive integration process that provides benefits to the poorest regions and most marginalized groups. These institutional strengthening programs will include specific components to promote an institutional bargaining capacity that takes into account social equity and balances and diminishes the negative impacts of integration on the poor; strenghthen the capacity of small and microenterpises to participate into export-oriented production chains; support protection instruments to offset the negative tax impacts of integration agreements on the poor; and strengthen institutions for social dialogue that include the most underprivileged sectors.

Developing regional cooperation in public goods that benefit the poor. In the area of regional cooperation, the Bank will support the creation of regional public goods that contribute, among others, to the reduction of poverty and inequality such as knowledge on the causes and identification of best policies to address these problems; initiatives in the financial sector to protect and promote the access of the most vulnerable sectors and the poor to savings and credit; identification of policies to develop border areas in depressed regions; and actions to support negotiation forums and the mobilization of financing, as well as other mechanisms to benefit the most underpriviliged populations.

The Bank will promote actions to *address the enviromental dimension of regional integration*, emphasizing marginalized zones that depend mainly on their natural resources base. Many of these communities rely on biological corridors with no borders. The Bank will promote the inclusion of these communities placing especial attention to the protection and adequate use of their natural resource base and environmental services generated in their areas.

MULTISECTOR SOCIAL PROTECTION SYSTEMS

The actions included in the four priority areas emphasize attention to structural factors associated with poverty and inequality. In addition, it is crucial that the region's social protection systems be expanded, since recurring economic crisis and natural calamities and the inability of the poor and the vulnerable to shield themselves against those aggregate risks or against idiosyncratic risks can severely hamper the fight against poverty. This requires a comprehensive set of actions to prevent, mitigate, and address the impact of these adverse shocks. The different components of social protection systems should be set up with sufficient anticipation and flexibility to facilitate a rapid and effective

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

response. Consequently, the Bank will support and encourage counter cyclical measures and the strengthening of multi sector *social protection systems* in the countries of the region to better address short-term and long-term vulnerability, incorporating informal safety nets that affected populations have already woven for themselves and civil society participation.

Social protection systems to weather economic crises. To improve social protections against economic crises, the Bank will foster implementation of prudent policies to avert crises, instruments to protect social spending and make it more counter cyclical (through vehicles such as Fiscal Stabilization Funds) and programs to assist the population facing sharp drops in income (such as targeted transfer programs and emergency employment programs, especially for the most vulnerable groups).

Social protection systems to contend with natural disasters. The Bank's support in this area will emphasize programs to improve the State's institutional disaster-response capacity; investment in basic infrastructure to reduce the risk of significant damage during disasters; regional and national early warning and information systems for weather events; emergency credit lines for post-disaster rebuilding of basic infrastructure; and financial products and access to capital markets (in coordination with other multilateral organizations) to provide insurance and financing for reconstruction (including calamity funds and insurance). These aspects will be strengthened in the Bank's policy and Action Plan for natural disasters.

Social protection systems to cushion against idiosyncratic risks. The Bank will promote programs to improve this kind of social protection systems, such as programs to extend social security coverage for health and pensions, private health and unemployment insurance, and retirement plans that take in the informal sector and assure minimum consumption levels for the indigent elderly. It is also worth noting that all Bank programs that take aim at structural poverty leave the poor less vulnerable to personal and aggregate risks by increasing their self-insurance capacity.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



OPTIONS FOR BANK SERVICES AND IMPLEMENTATION GUIDELINES

This Strategy for Poverty Reduction and Promotion of Social Equity provides a framework, which defines general principles to guide different priority areas supported by the Bank. The effective implementation of this strategy will occur through the execution of the action plan hereby defined in each one of the strategies of the four priority areas of Bank activity: Competitiveness, Modernization of the State, Social Development and Regional Integration, as well as those defined in the Environment Strategy that has a cross cutting nature. As previously stated, these strategies are aimed at the promotion of actions and policies needed to achieve poverty reduction and promote social equity. The services provided through Bank activity are defined by the organizational framework of the IDB Group, which includes: the Bank's public and private action; and coordination with the Inter-American Investment Cooperation and the Multilateral Investment Fund (MIF.)

The IDB Group can deploy its toolkit of financial and nonfinancial products to help reduce poverty and inequality in the region's countries. Financial products that can directly support countries' development and poverty reduction programs and policies are (national and regional multiphase) investment loans, sector loans, emergency lending, loans to the private sector, the Social Entrepreneurship Program, the Bank's new flexible lending instruments, technical cooperation loans and non reimbursable technical cooperation. A very sizable share of the Bank's lending program will be directed to poverty reduction and social equity enhancement, in pursuit of the Eighth Replenishment indicative targets of 50 percent of the number of operations and 40 percent of total loan approvals for those purposes. Among its non financial products are technical assistance and support for country-specific diagnostic assessments of the state of poverty and its causes, and support for the design and implementation of comprehensive poverty reduction strategies; policy dialogues; workshops, seminars, conferences and forums; social management training; research work; and generation and dissemination of information, good practices and lessons learned.

This strategy envisages the need for the Bank to tailor its selective support to the region's countries using a mix of its financial and nonfinancial instruments, deciding between them in accordance to careful, country-specific diagnostic assessments of the causes of poverty and inequality in each specific case, and the Bank's comparative advantages. Therefore, the instruments for support possessed by the Bank will be integrated through programming processes in the countries, having as resources the National Poverty Reduction Strategies, if available, as well as the country poverty documents contemplated in the Eighth Capital Replenishment. It is important to highlight that the priority and implementation activities contemplated in this strategy will be carried out in tight coordination with other country institutions, and bilateral and multilateral development agencies to avoid duplication of effort and tap the synergies of complementary interventions, thereby promoting a division of work according to the comparative advantages of each institution. Recent experience in coordination with the IMF, the World Bank and other

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

donors in the framework of preparing the Poverty Reduction Strategies, the experience with donors' round tables in countries in Central America and the Andean region, cooperation in improving information systems (such as the MECOVI program), and cooperation in monitoring and adapting the Millennium Development Goals to the reality of the region are examples of promising experiences of inter institutional coordination of actions to fight poverty and social inequity.

In the context of Country Strategies, programming priorities and actions must be identified in order to ensure quality design and successful execution of projects, so as to strengthen the effectiveness of the Bank's contribution. The Country Strategy Guidelines approved by the Board of Executive Directors (document GN–2020) define the appropriate operational framework for implementing actions at the country level, in accordance with the mandate set out in the Institutional Strategy (GN–2077). In this regard, it is essential that the strategic framework be formulated for each country according to these guidelines, with the analytical and procedural rigor required, in the key actions in terms of: programming; design; and execution of operations. Likewise, the present section specifies necessary activities to support these key actions in the areas of research, information gathering on the status of poverty, identification of best practices and diffusion of knowledge.

Programming Activities of the Bank. In the context of programming, the Bank has found support in dialogue instruments that have given quick response to government's demands. However, in line with document GN–2020 a more strategic programming framework based in detailed diagnosis on the causes of poverty and its possible solutions is required. Consequently, the Bank will strengthen the thematic of poverty and inequity reduction in the key documents and actions that guide its operations in the borrowing countries: country poverty papers, dialogue papers, high-level meetings for policy dialogue (*encerronas*), country strategies and country strategy updates, work plans, and portfolio reviews.

Country Dialogue and Strategy Paper as focal point of the strategy. In order to transition, in some cases, from having an agreement on a set of individual loans to having a more integral strategy for poverty reduction and promotion of equity, it is important to center on the country dialogue and strategy, and agree with the countries on lines of action based on an adequate diagnostic of the causes of poverty and inequality, integrated, when possible, to a National Strategy for Poverty Reduction that would allow defining the specific priorities and sequence of actions for Bank activities in the country. In their dialogues with country authorities, country divisions, in cooperation with the functional divisions, central departments, and the country offices, will stress strengthening activities for poverty reduction, including the formulation and implementation of poverty reduction strategies, improved targeting of public spending on the poorest groups, and consolidation of the many programs designed to reduce poverty. To carry out these activities, it is important to strengthen the technical capacity of the country divisions in the areas of poverty and equity.

Country poverty papers. As mandated in the Eighth Replenishment, the Bank will analyze in its borrowing member countries the causes of poverty and social exclusion as well as constraints to social progress. The core resource for the diagnostic assessments will be a series of studies (produced by the country, the Bank, or other agencies), that will include, among others, an analysis of the current state of poverty and its determinants, taking into account, the conceptual framework described in this strategy paper and the gaps for the achievement of the Millennium Development Goals. The focus of these papers should be to

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

come up with country-specific Bank action priorities. They will be basic inputs for fully incorporating poverty reduction and equity promotion issues into the country programming process, particularly into the Bank's country strategies, and supporting the possible development and implementation of comprehensive poverty reduction strategies. These papers will have first priority in countries that lack integral poverty reduction strategies fully integrated into the Bank's country strategy.

Design and Implementation of integral strategies and targeted initiatives. To help its member countries design and implement comprehensive poverty reduction and equity promotion strategies and targeted initiatives, the Bank will make available its current facilities for the production of studies and for program and project development. These include country poverty papers, pre-investment loans, the Project Preparation Facility, technical cooperation operations, and lending products. In its support to countries the Bank will focus primarily, though not exclusively, on areas in which it has identified its strongest comparative advantage: social sector development, modernization of the State, fostering competitiveness, and support for integration initiatives. The Bank's operations in support of targeted initiatives and comprehensive strategies for poverty reduction will center on human capital investment (to reach the Millennium Goals for education, gender parity and health), nonsocial areas (infrastructure, production sectors, institutional quality enhancement), reducing social exclusion by reason of ethnicity, gender, disability, or AIDS; and social protection, including mechanisms to protect the unemployed, emergency employment programs, social safety nets, health insurance, pensions, and social spending protection protocols, among others. To improve program targeting, progress must continue to be made in the development of cost-effective systems for beneficiary identification.

Project and Program Design. The Bank must support actions aimed at improving and encouraging quality in the design of projects and programs. This means identifying and implementing incentives to promote more systematic work with regard to: timely and appropriate access to financing resources for project design; systematic incorporation of lessons learned and the dissemination of information and best practices; coordination/integration of cross-cutting themes among operational divisions and departments within the Bank as well as with bilateral and multilateral financing agencies.

Access to technical cooperation financial resources for the design of projects. At present, the project team and technical counterparts in the countries do not always have readily available resources for the design of projects in terms of amounts available, or restrictions on the scope and priority of technical assistance based on the fiduciary fund that supports it. Therefore, while implementing the strategies of priority areas and country strategies it is important to identify processes that might reduce transaction costs for the use of these resources and those that increase the flexibility of technical assistance.

Coordination and integration of horizontal themes. It is necessary to improve the framework of coordination between financing agencies (bilateral and multilateral) and between the Bank's divisions and departments, particularly in critical integrative areas such as rural development, modernization of the state and decentralization, the management of local development funds, and environmental management. This improvement will avoid the duplication of efforts and will also avoid giving contradictory signs over the priority processes of poverty reduction and social equity promotion. To reach this goal, the establishment of an incentive-based mechanism that promotes, rewards and guarantees the coordina-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

tion and integration of efforts in the design of the projects is required.

Execution of operations and programs. The executing agencies and the Country Offices of the Bank must have the technical, professional, and financial instruments at the country level to ensure attainment of the established objectives. These instruments should include: expeditious access to technical assistance during program execution; formalized technical audits of the operations; systematization of lessons learned and feedback for new projects; and training of professionals in line with demand for new projects.

Support for strategy, policy, and program monitoring and evaluation. As established at the recent Conference on Financing for Development in Monterrey, measurement and monitoring of the effectiveness of actions in support of development requires special attention. To that end, mechanisms need to be established to monitor the implementation progress of poverty reduction strategies and activities, with indicators and monitoring and evaluation systems for policy, program, and development target tracking. The Bank's resolute support for monitoring and evaluation capacity development, with participatory elements, is crucial to be able to improve, adjust and adapt poverty reduction policies on the strength of lessons learned. This includes strengthening the monitoring and evaluation of projects financed by the Bank. The action plan proposes impact evaluations, in concert with the countries, of representative projects in the different sectors of Bank activity. As part of their design these projects should include elements needed for a careful evaluation of their impact, such as baseline construction and the use of control group techniques.

Research and Analysis. The necessary underpinning for the design of poverty reduction and equity enhancement policies and programs is a solid understanding of poverty and its determinants. The Bank will spearhead the generation and dissemination of knowledge about poverty and inequality in the region and policies to combat them. Critical items for the research agenda include: the relation between economic growth, poverty and inequality; the need for robust social safety nets to protect against personal and collective risks; the tie-in between human capital investment and the reduction of the generational transmission of poverty and inequity; the effects of trade reforms on labor markets; the relationship between financial markets and poverty; the roots and costs of race- and ethnicity-based social exclusion and inequality, and the policies to fight it; the relationship between gender and intra-household poverty and inequality, including the impact on children; innovative remedies for basic infrastructure deficits that are a problem largely for groups living in extreme poverty; the distributional impact of public service privatization and deregulation; the relationship between decentralization and quality of basic services; public sector reform and poverty; social capital and poverty; and the development of rural economies, among others.

Support for generating information on the poverty situation. Monitoring and evaluation of actions to combat poverty, and an adequate analysis of its causes, requires adequate generation of information on poverty and its determinants. The Bank will put special emphasis on programs to improve information systems on socioeconomic conditions in the region, including programs to improve living standards surveys (such as the MECOVI program) and censuses, and to strengthen national statistics institutes. The Bank's action in this field will place priority on generating reliable disaggregate data (by income level, place of residence, ethnicity, and gender) on the levels and characteristics of poverty, and progress on effort indicators and results relating to the Millennium

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Development Goals and other regional commitments, with special emphasis on countries with less capacity in the field.

Good practices and lessons learned in policies, programs and projects. The Bank will identify good practices and lessons learned in policies, projects and programs that have taken aim at the different dimensions of poverty, and will disseminate them through its various activities for dissemination and training in public administration. There should be special emphasis on identifying good practices for poverty reduction in non-social areas, such as financial products for the poor, infrastructure, and modernization of the State. Another focus of special attention will be the development of good practices in innovative interventions, such as targeted human development programs, early intervention, social protection and social inclusion programs, and the use of information technologies by the poor. To step up the ongoing effort to identify policy, program and project good practices, more evaluations will be made available of the impact of public poverty reduction initiatives in the region.

Dialogue and knowledge dissemination: conferences, forums, networks, seminars, and workshops. The poverty reduction and social equity promotion objective should figure high on the regional policy agenda and on individual country agendas. One of the Bank's advantages is its capacity to promote and maintain long-term agendas in the region, particularly in the context of changes in government as a result of power changing hands. The Bank will continue to foster and facilitate dialogue and consensus-building in pursuit of that objective, bringing the following products to bear: organization of regional policy dialogues among senior public officials in the poverty reduction and social equity sphere, regional forums like the Social Equity Forum, and regional seminars and conferences on issues pertaining directly to poverty and social equity.

Action plan. The implementation proposed here to tackle the priority objective of poverty reduction and social equity promotion will be done through the actions described in the four sector strategies of Competitiveness, Social Development, Modernization of the State, Regional Integration and the Environmental Strategy which has a cross cutting nature. This section highlights some particular elements required to strengthen the relation of the strategy with the programming exercises and the impact of the Bank actions in poverty reduction and social equity promotion, in the framework of the Eighth Replenishment mandates, and in close coordination with other national, bilateral, and multilateral development agencies. The following are the specific activities proposed:

- Make headway in the preparation of country-specific poverty papers for the borrowing member countries, as mandated in the Eighth Replenishment. These papers will enable poverty reduction and social equity issues as well as the Millennium Development Goals and other regional commitments to be fully incorporated into the country programming process, including the Bank's country strategies. One condition for this activity to be viable will be to strengthen the regional department country divisions, adding poverty specialists.
- Strengthen the support to the development and implementation of comprehensive poverty reduction and social equity promotion strategies at the national, subnational, or sector level in borrowing member countries.
- Strengthen the support to the improvement of household surveys, and poverty and living condition indicators in borrowing member countries through the MECOVI program.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

- Integrate and disseminate best practices and strengthen support to implement targeting systems for poverty reduction programs.
- Raise the share of Bank operations directly oriented to the objective of reducing poverty and promoting social equity, giving importance to those loans directly intended to help reach the Millennium Development Goals; promote social inclusion of marginalized groups; promote the creation of opportunities for the poor through activities in nonsocial areas (infrastructure, micro enterprise, rural development, and modernization of the State) and strengthen the capacity for the development and implementation of policies and programs to reduce poverty and enhance social equity; and give the poor access to social protection.
- Advance in the impact evaluation on poverty and social equity of Bank's projects in the priority areas mentioned above.
- Strengthen inter- and intra-departmental coordination within the Bank to achieve adequate harmonization and use of lending instruments and windows focused on the objective of poverty reduction and social equity, and especially in the achievement of the goals in the areas previously specified.

The comprehensive implementation plan of the group of sector strategies includes the efforts required to strengthen the emphasis and priority of the objective of poverty reduction and promotion of social equity in Bank activities as well as a timetable to implement those activities.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



MONITORING, EVALUATION, AND PERFORMANCE INDICATORS

The monitoring of the implementation of the Poverty Reduction and Social Equity Promotion Strategy will be carried out by way of output, outcome, and impact indicators. Monitoring will be supported by the work being done to improve measurement of the development effectiveness of the operations throughout each phase of the project cycle, including programming, goal-oriented design, and results-oriented execution. Output indicators include information from the operations program; outcome indicators provide information on direct results of Bank activities, and impact indicators include information on key variables, which measure the accomplishment of the ultimate purpose of the strategy and the actions taken by the countries of the region. Apart from continuing to monitor the Eighth Replenishment indicative lending level targets for poverty reduction and social equity enhancement (SEQ), the Bank will monitor the percentages for the priority areas listed in the action plan in the previous section.

Output indicators: Number of country poverty papers the Bank produces; number of countries receiving Bank support for comprehensive poverty reduction strategy development and implementation; number of countries receiving Bank support to improve household surveys through the MECOVI Program and to improve targeting systems; number of nonfinancial products deployed in the area of poverty reduction and social equity; number of project impact evaluations; proportion of Bank lending for human capital investment that is directly intended to help reach the Millennium Development Goals; proportion of Bank loans intended to promote social inclusion of marginalized groups; proportion of Bank SEQ lending to nonsocial areas designed to create equal opportunities for the poor and strengthen the capacity for the development and implementation of policies and programs to reduce poverty and enhance social equity; and proportion of SEQ lending for priority social protection programs for the poor. In particular, it is proposed to complete the poverty documents by country in 2005.

Outcome indicators: Summary of SEQ and PTI project results, which include monitoring of changes in social indicators, living standards, and the institutional environment identified in the projects and strategies of the country, and of outcomes of nonfinancial products that help reduce poverty and promote social equity. A central focus will be the findings of Bank projects evaluations, including their impact on poverty and social equity; which will serve as lessons learned to refine or adapt the areas and programs given priority in this strategy.

Impact indicators: Regional and country poverty rates, measured against the international poverty lines of one dollar and two dollars a day (in purchasing power parity), income distribution coefficients such as the Gini index and bottom-quintile share of national income, and indicators of the severity of poverty such as the mean income gap of the poor, and other indicators from the strategies of the priority areas, which are directly relevant to poverty and inequality, and to the monitoring of the Millennium Development

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Goals. Though changes in these indicators could not be attributable directly or entirely to specific Bank activities, the indicators, broken down by income groups, gender and ethnicity, will be important referents to guide Bank action in the future.

The Bank's annual reports on activities to reduce poverty and promote social equity will include advances in the implementation of this strategy starting in 2004. An evaluation of the strategy will be performed five years after it enters into effect.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



ANNEX

Summary of Areas for Bank Action

Box 1: Poverty Reduction And Promotion Of Social Equity

Support for the formulation of national strategies for poverty reduction

Analyze poverty determinants
Select priority activities and objectives based on Millennium Development Goals (MDGs)
Define action plans
Support supervision and evaluation

Competitiveness

Expand financial resources for the poor
Improve property rights of the poor
Improve poor workers' employment opportunities
Promote inclusion through basic infrastructure services for the poor
Access to science and technology for the poor
Cooperation between the public and private sectors to increase the competitiveness of the poor
Productive use of natural resources in marginalized communities

Social development

Reduce inequality in access to education, health and housing services
Equal opportunity during the life-cycle
Eliminate social exclusion through the development of social capital
Local and territorial levels as key elements for poverty reduction
Social development and attention of environmental degradation in poor areas

Modernization of the State

Consolidate the democratic system and the political inclusion of the poor
Promote the Rule of law and the access of the poor to justice
Improve the links between the state, markets, and equity
Support public management to promote equity
Environmental governance at local level

Regional integration

Promote the positive impact of regional trade on the poor's welfare.
Invest in regional infrastructure in less developed areas
Adequate institutions for the negotiation and implementation of balanced agreements aware to economic inclusion
Promote regional cooperation in regional public goods that benefit the poor
Environment in marginalized transborder zones

Social protection systems

Promote social protection against economic crises
Promote social protection against natural disasters
Promote social protection against individual risks

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

MODERNIZATION OF THE STATE

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This Strategy has been prepared by a team that includes: Edmundo Jarquín (SDS/SGC, team coordinator), Orlando Reos (RE1/SC1), Jorge Sapoznikow (RE2/SC2), Xavier Comas (RE3/SC3), Rosina de Souza (LEG) and Koldo Echebarría (SDS/SGC). The document is part of a group of strategies whose preparation has been coordinated by Carlos M. Jarque (Manager, SDS) and benefited from the specific contributions of Ernesto Castagnino (SDS/SGC), Christina Biebesheimer (SDS/SGC), Fernando Carrillo (SDS/SGC), Carlos Cordovez (SDS/SGC), Janine Perfit (SDS/SGC), Mark Payne (SDS/SGC), Leslie Harper (SDS/SGC) Betty Rice (RE1/SC1), Francisco Mejía (RE1/SC1), Lynette Asselyn (RE1/SC1), Fabricio Opertti (RE2/SC2), Rodrigo Tamayo (RE2/SC2), Carlos Pimenta (RE3/SC3), Raimundo Arroio (RE3/SC3), Gustavo Yamada (SDS/POV), Robert Vitro (SDS/ICT), Carlos Perafán (SDS/IND), Luis Fierro (SDS), David Wilk (SDS/ENV) y Renato Puch (DPP). Groups of civil society organizations were consulted in Argentina, Brazil, Bolivia, Chile, Honduras, Jamaica, Mexico and Peru and with the Network of Civil Society Organizations on Justice (Quito), the Latin American Association of Popular Organizations, The Consultative Committee on Central American Integration and the Transparency and Public Management Network of the IDB (Washington). Workshops with experts on the topic were organized by the Institute of International Governance in Barcelona (Spain) and by the Latin America Council of Administration for Development (CLAD) in Caracas. In addition, comments were received through the Bank's website, the International Governance Institute and the Inter-American Network for Democracy.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

OBJECTIVE



The Eighth Capital Replenishment establishes a mandate for the Bank to work with a more comprehensive approach to development that seeks to consolidate economic reforms while also promoting internal socioeconomic cohesion, regional integration, environmental protection, modernization of the state, and the strengthening of democratic institutions and of civil society, as the means to achieve sustainable economic growth, poverty reduction, and promotion of social equity. Based on this mandate, on March 13th, 1996 the Bank's Board of Directors approved the "Frame of Reference for Bank Action in Programs for Modernization of the State and Strengthening Civil Society" (GN–1883–5), that has served as the strategic channel for Bank action in this sector up until now.

The objective of this strategy consists in bringing up to date the cited document, adjusting it to fit with the requirements of the framework strategies related to sustainable economic growth, and poverty reduction and social equity and establishing the necessary connections with the sectoral strategies related to social development, competitiveness, regional integration, and the environment. The document reflects the lessons learned from the Bank's experience, the theoretical and practical advances in the subject, and the evolution of the needs and demands of the region in the last few years. This strategy establishes the basic criteria that should guide Bank programs in this field, defines the priority areas of action, and indicates the available financial and non-financial instruments. In addition, it defines the criteria for evaluating its implementation, proposing a collection of output, outcome and impact indicators.

In accordance with the mandate contained in the Eighth Replenishment, the strategic framework up to now in force as well as this document take the expression modernization of the state to mean state reform for the consolidation of democratic governance. Governance comprises the process through which authority is exercised in a given political community, including: (i) the form through which the holders of authority are elected, monitored, and replaced; (ii) the principles and norms guiding the interactions between the state, the private sector, and civil society organizations, particularly in respect to their responsibilities and functions; and, (iii) the capacity of the political authority to identify needs, collect resources, and define and implement policies. Governance is democratic when a series of requirements are met in respect to how authority should be exercised and under what socioeconomic conditions: first, the requirement of representativeness that legitimizes public authority through free elections; second, the existence of mechanisms for the effective constraint and division of power, for ensuring the accountability of public officials to citizens and respect for citizen rights and liberties; third, controls on arbitrariness so that authority is exercised in a manner consistent with the law and the constitution, with effectiveness and efficiency in the assignment of resources to social needs and with transparency and integrity in the behavior of public officials; and finally, democratic governance requires conditions in which the enforcement of the principles of solidarity and subsidiarity per-

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

mit a consensual and effective relation between different social actors in a context of social cohesion.

The state, despite its weaknesses and imperfections, is the backbone of democratic governance. But, the quality of democratic governance is shaped not just by state institutions, but also by their interaction with market institutions and civil society. In this sense, a strong civil society participating in the design and implementation of public policies through representative institutions is an essential condition for the effective functioning of democracy and for achieving sustainable and equitable development. To that regard, and consistent with the requirement of social cohesion as one of the conditions for democratic governance, it should be taken into account that the principal foundation of a robust civil society, beyond its organizational dimension that is manifested in a large number of social organizations, is the existence of economic opportunities and democratic freedoms for all citizens. Therefore, the strengthening of civil society is linked to the set of economic and social policies that promote human development and broaden the possibilities for the full exercise of citizenship by all persons.

In this meaning, democratic governance not only refers to the attributes of a political and administrative regime, and the effective enforcement of the rule of law, but also the capacity of a society to face the challenges confronting it and create solutions based on a solid social consensus. A modernization of the state strategy, as development and improvement of democratic governance and defined by the same requirements, is therefore, a strategy for the construction of institutional capacity in the state and in the whole society. In other words, the development of democratic governance implies, therefore, a complementary and reciprocal process of strengthening the state and civil society in the way noted above.

This strategy has been formulated on the basis of the general and specific requirements of the overarching strategies related to sustainable economic growth and poverty reduction and promotion of social equity (Annex I). Sustainable and equitable development requires a democratic, modern and efficient state that promotes economic growth, establishes a regulatory framework conducive to the efficient functioning of markets, that guarantees a stable macroeconomic environment, that is capable of adopting social and economic policies appropriate for poverty reduction and environmental preservation, and that implements such policies in an efficient, transparent and accountable manner. In the development debate a consensus has formed that the quality of public institutions is an essential, and perhaps the most important ingredient for sustainable economic growth. Therefore, this strategy pays special attention to the institutional and political requirements of a solid strategy for economic and sustainable growth. On the other hand, there is a broad recognition that the consolidation of democratic systems, beyond strictly the electoral dimension, implies a reciprocal and complementary process of improving the situation of the poor in such a manner that increases their opportunities to have their interests represented in the process of formulating and implementing public policies. As a consequence, this Modernization of the State Strategy is formulated from the perspective of supporting a sustained process of poverty reduction and social equity promotion.

In the same manner, this strategy pays attention to the connections and interrelationships that can be observed in relation to the other basic sectoral strategies of the Bank. In relation to the social development strategy, it is taken into account that the effectiveness of efforts in this area depend on the institutional capacity of public organizations and the existence of collaborative structures between different levels of government and a complementary relation between social actors and the market. In relation to the competitiveness strategy, the need for the state to

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ensure a solid and stable macroeconomic environment, to carry out necessary investments in social and economic infrastructure and human capital, promote competition and capacity for innovation, provide an appropriate regulatory framework, and guarantee the predictability and stability of the legal system and policy environment is emphasized. In relation to the regional integration strategy, the modernization of the state strategy takes into account the fact that the goal of regional integration depends on the institutional capacities of countries to define and implement commercial and customs agreements, develop an appropriate infrastructure for the exchange of capital, goods and services and labor, as well as common economic and social policies and progress in the convergence of legal and political systems of the countries. Finally, in relation to the environment strategy, it is recognized that political-institutional weaknesses that result in poorly designed, absent or ineffectively implemented policies constitute one of the principal causes of environmental vulnerability.

In the last few decades the Bank has supported the countries of the region, through a considerable quantity of financial and technical assistance operations, in the process of economic reforms oriented towards economic stabilization, consolidating the market economy, increasing trade openness, eliminating subsidies that distort competition and efficiency, and privatizing productive activities and service provision. These economic reforms, supported by the Bank, have resulted in an important transformation in the relationship between the state, market and different social actors. In addition to the institutional reforms directly associated with the economic reforms mentioned, the Bank has widened its activities to include operations aimed at supporting the countries in their efforts to consolidate the democratic system and the rule of law.

In fact, over the last decade a growing importance has been attributed to democratic governance for achieving the objectives of sustainable and equitable development. In the agenda of development policies of the countries and of the bilateral and multilateral cooperation organizations, the promotion of democratic governance (albeit with somewhat different emphases and nuances) has become one of the fundamental pillars to achieve and sustain the goals of development. A cumulative experience and academic knowledge has reaffirmed the conceptual framework adopted by the Bank, in the sense that the success of efforts to reduce poverty and achieve sustainable development requires a substantial increase of institutional capacity and a favorable political environment. The recognition of the positive contributions of democracy to development is now added to the recognition of its intrinsic value in respect to the promotion of freedom and human rights (see Box 1, for the mandates to this regard).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Box 1: Democracy and Development in the Mandates of the Summits of Heads of State and Government

Declaration of Miami, 1994

Democracy is the sole political system which guarantees respect for human rights and the rule of law; it safeguards cultural diversity pluralism, respect for the rights of minorities, and peace within and among nations.

Democracy is based, among other fundamentals, on free and transparent elections and includes the right of all citizens to participate in government. Democracy and development reinforce one another.

Democracy is strengthened by the modernization of the state, including reforms that streamline operations, reduce and simplify government rules and procedures, and make democratic institutions more transparent and accountable.

Plan of Action of Miami

The strengthening, effective exercise and consolidation of democracy constitute the central political priority of the Americas.

Governments will:

Encouraging opportunities for exchange of experiences among member states, democratic institutions, particularly legislature-to-legislature and judiciary-to-judiciary.

Declaration of Santiago, 1998

The strength and meaning of representative democracy lie in the active participation of individuals at all levels of civil life. The democratic culture must encompass our entire population. We will strengthen education for democracy and promote the necessary actions for government institutions to become more participatory structures.

Confident that an independent, efficient, and effective administration of justice plays an essential role in the process of consolidating democracy, strengthen its institutions, guarantees the equality of all its citizens, and contributes to economic development, we will enhance our policies relating to justice and encourage the reforms necessary to promote legal and judicial cooperation.

Plan of Action of Santiago

Governments will:

Include in educational programs, whiting the legal framework of each country, objectives and contents that develop democratic culture at all levels, in order to teach individuals ethical values, a spirit of cooperation and integrity. To that end, the participation of teachers, families, students and outreach workers will be stepped up in their work related to conceptualizing and implementing the plans for shaping citizens imbued with democratic values.

Declaration of Quebec, 2001

We acknowledge that the values and practices of democracy are fundamental to the advancement of all our objectives.

The maintenance and strengthening of the rule of law and strict respect for the democratic system are, at the same time, a goal and a shared commitment and are an essential condition of our presence at this and future Summits.

Democracy and economic and social development are interde-pendent and mutually reinforcing as fundamental conditions to combat poverty and inequality. We will spare no effort to free our fellow citizens from the dehumanizing

Plan of Action of Quebec

Make Democracy Work Better

Recognizing the relationship among democracy, sustainable development, the separation of powers, as well as effective and efficient government institutions, and, noting that the transparency and accountability of electoral systems and the independence of bodies responsible for the conduct and verification of free, fair and regular elections are essential elements in ensuring support for and involvement in national democratic institutions.

Share best practices and technologies with respect to increasing citizen participation in electoral process.

Declaration of European Union Sum-mit – Latin America and the Caribbean, Madrid, 2002

We consider it important to continue to strengthen democracy and consolidating democratic institutions that, inter alia, guarantee free, fair and participatory electoral processes based on universal suffrage and respect for the Rule of Law. We strongly support the principle that the national judicial systems should be independent and impartial.

We believe that democracy, the Rule of Law and economic and social development are elements of fundamental im-portance for peace and stability

We reaffirm our commitment for all human rights, civil political, economic, social and cultural rights, including the right to development, and fundamental freedoms taking into account their uni-versal, interdependent and indivisible character in accordance with the UN Charter and the human rights instruments agreed internationally, together with the 1993 Vienna Declaration on Human Rights and the Programme of Actions.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

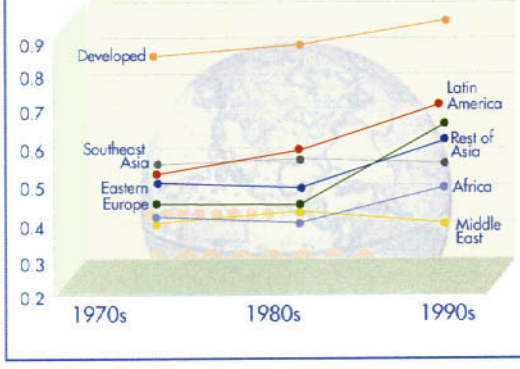
Historically, an inadequate relationship has existed between the state and the market, on the one hand, and between the state and citizens, on the other, that has translated into an erosion of the possibilities for sustainable and equitable development. The situation is not the same in all the countries, and in the last few decades, a set of important processes have been implemented in the region that aims to address these areas of dysfunction. Nevertheless, from a historic perspective it is clear that there has been a democratic deficit occasionally expressed in the phenomena of authoritarianism, clientalism, corruption, and "capture" of institutions and public policies by particular interests. These political system features have resulted in state actions that discourage an efficient functioning of the market and instead promote rent seeking and speculation. At the same time, these same weaknesses have contributed to a policy-making process in which the resulting policies do not reflect the processing and aggregation of the demands of the majority of citizens but rather lead to the exclusion of broad sectors from the benefits of growth and to the delegitimation of the state. This democratic deficit is also responsible for the paradox of the region's long periods of significant economic growth in the absence of reasonable degrees of social cohesion. A consequence of this inadequate relation between the state and society is chronic political instability and changing rules of the game that have discouraged saving and investment. The above analysis implies the necessity of promoting a state reform process oriented to overcome these dysfunctions in the relation between the state and citizens on the one hand, and between the state and the market on the other.

Nevertheless, there are important positive tendencies. It should be emphasized that with regards to the relationship between the state and citizens, in the last two decades, democratic regimes of government have been established in the countries of the region. This has brought significant improvements in terms of the protection of human rights, freedom of expression, exercise of individual political freedoms, and the expansion of the opportunities for the participation of citizens in public policy-making (See Graph 1).

In addition to progress regarding political freedom and the protection of human rights, the region as a whole has been carrying out important efforts to consolidate the rule of law and independence between the branches of the state, improve the regulatory capacity of the state, and provide macroeconomic management and monitoring and supervisory agencies with technical capacity and profes-

FIGURE 1

Democratic Freedom and Civil Liberty
(Jaggers and Gurr, 1995 and Freedom House, 1999)

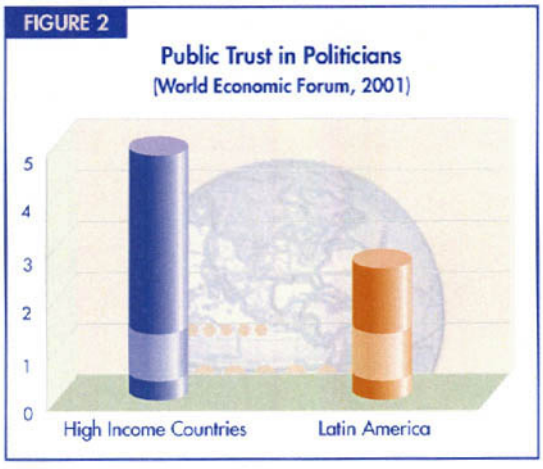


Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

sional independence. Similarly, a wide process of decentralization that has deepened democratic tendencies and has brought the government closer to the population has been observed.

Nevertheless, there remain important weaknesses that call into question the political-institutional strength of these democratic regimes. Political institutions important to securing the legitimacy and trustworthiness of the democratic system in some cases suffer from important deficiencies: (i) The legislatures are typically characterized by operational, administrative, and resource problems that limit the fulfillment of their legislative, representative, oversight and monitoring responsibilities which affect the capacity to generate political and social consensus, the quality and consistency of laws, and the exercise of an effective and responsible oversight of the executive; at the same time, the mechanisms for the participation of citizens in legislative work are weak; (ii) the party system reflects great weaknesses, including the lack of capacity to process and aggregate citizen demands and represent general interests; (iii) in spite of the notable advance in the last couple of decades, in some countries more work is needed in perfecting electoral systems to ensure their effectiveness and credibility; (iv) equally, in some countries the democratic civil control of the armed forces occasionally manifests important institutional weaknesses; (v) audit and other supervisory institutions do not always have the independence, objectivity, and technical capacity necessary for them to be able to oversee adherence to the law, integrity, and effectiveness of the actions of public officials and of transactions between the state and economic actors; (vi) finally, and despite a significant expansion in the number of organizations, civil society remains relatively weak because of the socioeconomic exclusion of vast sectors of the population. All of the above weaknesses can be related with indicators that show a low perception of political stability in the region and the lack of confidence of the population in politicians (Graph 2).

FIGURE 2



Another aspect of the relation between the state and citizens has to do with the institutional requirements of the rule of law. An assessment of the state of justice in the region reveals the persistence of problems, including: the lack of judicial independence, the obsolescence of laws and procedures, congestion in the court system; a scarcity of resources; the absence of modern systems of organization, information, and administration; barriers of access and the limits of the coverage of the system; the deficiency and poor state of the physical infrastructure; and the precariousness in the protection of fundamental rights. The result is justice with low credibility and inequality that denies or limits the access of broad segments of the population, without the capacity to reliably uphold and enforce rights and obligations or effectively impose sanctions to curb the growth in different forms of crime and other threats to citizen security. Comparison of the perceptions of the independence and integrity of judges, as well as the indicators of confidence in the justice system, illustrate the relatively unfavorable situation of the region in relation to the developed countries (Graph 3).

Even though it is difficult to identify a paradigmatic process of decentralization in the region, one can find some common defi-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

FIGURE 3

Judicial Independence and Integrity
(World Economic Forum, 2001)



ciencies. Among these deficiencies could be included: the imprecision in the distribution of responsibilities; an imbalance between responsibilities and resources, larger fiscal deficits, the "capture" of subnational governments by local elites, scarce technical preparation of those who have been leading these processes, the lack of efficiency and effectiveness in the provision of decentralized services.

As a consequence of the institutional weaknesses noted above, existing indicators reveal levels of perceived corruption (Graph 4) that are incompatible with the legitimacy of public institutions, efficient operation of markets, an efficient management and allocation of resources, and the existence of a system of incentives consistent with the need to expand savings, investment and production. The prevalence of corruption is to some degree an expression of the weakness of the rule of law as a whole, but calls attention also to the weakness of the state's financial administration, poor policy design, inefficient and deficiently transparent expenditure systems, the persistence of antiquated and inefficient procurement and public contracting systems, nonexisting or inefficient regulatory capacities, absence of clear rules in the process of privatization, and the lack of a modern merit-based civil service.

The relation between the state and the market also has experienced very important changes derived from the economic reform process carried out over the last two decades. These reforms have resulted in gains in terms of macroeconomic stability, creating an environment more favorable for investment. In addition, entire sectors of productive activity, once dominated by inefficient state monopolies, have been opened to the market. In a similar manner, trade barriers and sector-specific regulations restricting internal and external competition have been dismantled. Nevertheless, the move towards an economy in which market forces play a more central role has not been sufficiently accompanied by the development of effective regulatory capabilities that promote competition, reduce rent seeking and protect the common good. In addition, the move to a market economy has been unequal, and in not a few cases, has been based on the capacity of organized interests to take advantage of or resist the opening. It is also important to note the absence of broadly inclusive social partnership mechanisms that include those interests that are positively or adversely affected by the reforms, in such a manner that the countries can have long-term strategies based on a wide social consensus. At the same time, as a consequence of the fiscal crises, policies and institutions established to promote and support productive sectors have been abandoned. Nor has there been sufficient progress in the

FIGURE 4

Absence of Corruption Perception Index
(Transparency International, 2001)



Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

adoption of fiscal reforms that broaden the tax base and share the tax burden in a more equitable manner. Confidence in respect to the basic economic rights indispensable for the promotion of investment and productive development continues to be absent (Graph 5). At the same time, in many cases the state's capacity to provide public goods and basic infrastructure necessary to promote social cohesion and the expansion of production activities has weakened. In this context, the necessary emphasis on the operation of markets should be accompanied by the recognition of the complementary and important role played by public policies and institutions. As shown by diverse studies, the countries that have benefited the most from economic reforms are those that have advanced more in implementing institutional reforms consistent with the requirements of democratic governance.

The relation of the state, both to citizens and to markets, is conditioned by the capacity of the public administration to make and implement public policies. During the last two decades, however, public administration reforms have not, for the most part, increased this capacity since in general they have been carried out under the pressure of severe fiscal crises and recurrent external shocks. More than administration reforms, they are more appropriately described as administrative consequences of fiscal adjustment whose effects have been the reduction of the public administration in the majority of countries (Graph 6). The 1990s have brought an advance of the reform agenda towards modernization projects oriented to achieving more effective and efficient administrations through new structures and procedures supported by new information and communication technologies. The balance of these projects has been uneven, with some advances achieved in fiscal and economic administration but deeper institutional reforms of the administrative apparatus remain pending in a majority of the countries,

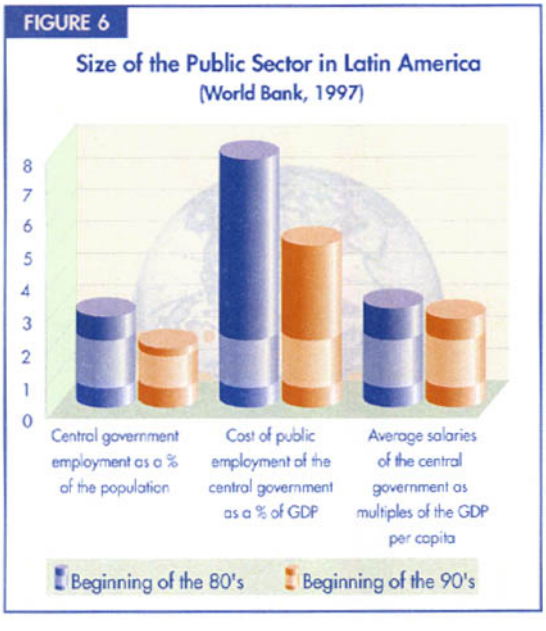
FIGURE 5



especially in the social sectors. It is not surprising that a regional comparison of the perceptions of the competence and professional independence of public officials is also unfavorable for the region. Finally, the delay in taking advantage of the possibilities of electronic government also clearly illustrates the deficits in relation to the modernization of the state in the region.

Thus, in spite of the advances in the region in respect to democratic freedoms, economic reforms, and state modernization, important institutional deficiencies remain

FIGURE 6

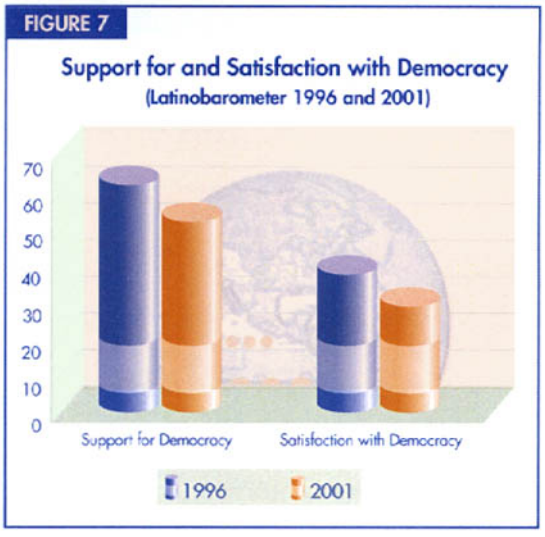


Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

which impede efforts to promote sustainable and equitable development. The consequence is a deep dissatisfaction of citizens with the functioning of state institutions and the political system in its entirety. The legitimacy of democracy as a system of government also shows signs of erosion (Graph 7). These tendencies are very worrisome.

All of the evidence and accumulated knowledge makes it clear that the solution to the outlined problems can only be found in institutions central to ensuring democratic governance. Only the consolidation and strengthening of the democratic system, the rule of law, and institutions that support competitive and inclusive markets, and the establishment of efficient public administrations, can guarantee the achievement of sustainable growth and the reduction of poverty. It is for that reason, that these priority areas of action for the Bank are included in scope of this Modernization of State Strategy. This conclusion needs special emphasis in light of the international trends in which the region is immersed. The opportunities and challenges presented by these trends, including those derived from globalization, the technological revolution, the consensus in respect to democracy and the market economy, as well as the cumulated deficits in terms of poverty, inequality, political and institutional weaknesses, insufficient development of productive capacity and the deterioration of the

FIGURE 7



environment, require, on the one hand, to increase the efficiency of the relation between the state and the market, and, on the other hand, to strengthen the capacity of the state to act as an agent of progress and general welfare. State reform and modernization continues to lag in comparison with the progress of globalization processes, new technology, the requirements of competitiveness and the cultural transformation of society. Without strategies that contribute to overcoming the political-institutional weaknesses that prevail (although with variations depending on the country) in the region, it will not be possible to obtain sufficient progress in respect to development and the reduction of poverty.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



LESSONS LEARNED

The Bank has experienced a considerable growth and diversification of its activities in the area of state modernization and reform, especially stemming from the approval of the Frame of Reference mentioned in the first chapter. From the lessons learned from the Bank's experience (see Box 2 regarding a Bank special study on the topic) and that of other institutions, as well as the conceptual framework set forth in the preceding sections, and considering the conditions facing the countries of the region, a set of criteria for guiding the Bank's and countries' actions in state reform and modernization processes can be defined.

This section presents a set of lessons learned, grouped into two categories, which result in criteria to guide interventions. First, those related to the conceptual framework, and second, those related to the process of design and execution of interventions.

LESSONS RELATED TO THE CONCEPTUAL FRAMEWORK

Conceive modernization of the state operations as a process of political reform. The redesign of institutions and processes, in terms of their effectiveness vis-à-vis the relation between

Box 2: IDB Experience with Modernization of the State Operations

At the request of the Board of Directors of the Bank, the Regional Operations Support Office (ROS) carried out a study of the Bank's experience in Modernization of the State operations. A total of 22 projects were analyzed that provided a representative sample of the different geographical areas, phases of implementation, and types of operations, whether technical cooperation programs, loans, or non-reimbursable funds. The study concluded that the majority of these operations had been executed successfully and that some of them represented valuable examples of good practices to follow in future operations of the Bank. Nevertheless, problems of design and execution were seen to have limited the achievement of the project's objectives in an important percentage of the cases.

Based on the accumulated experience the following lessons can be derived for achieving success in this type of operation:

- These operations depend on very favorable socio-political conditions and thus need to be associated with windows of opportunity that are opened in the political and economic cycles of the countries.
- Experience demonstrates that it is crucial to involve the key stakeholders in the processes of information gathering or participation in order to achieve a broad consensus.
- The availability of studies and previous analytical work has been shown to be of great utility for permitting a good knowledge of the country and for helping to correctly identify the areas for intervention and the rhythm and stages of the changes.
- The complexity of these projects and the incremental character of the changes to be carried out requires a long term perspective and a broad vision of the institutional and legal environment of the country.
- The more successful projects have been led by the borrower and implemented by a permanent and capable executing unit.
- Finally, it is clear that because of their characteristics these projects can require greater flexibility in Bank procedures and instruments.

ROS – Special Study IDB Experience with Modernization of The State Operations, March 2002

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

the state and the market and in terms of the capacity of public policies to respond to the interests of all of the citizens, should form part of a broader process of consolidating the institutional requisites for democratic governance. The lessons learned in respect to sustainable economic growth and poverty reduction highlight the importance of democratic governance. On the one hand, there is a consensus between development agencies that the quality of public institutions—especially those related to the rule of law and the fight against corruption—is an essential ingredient, and perhaps the most important, for achieving sustainable economic growth. The recent experience in the region, in which the achievement of fiscal balance has tended to be given the highest priority, which combined with the notion that institutional reforms can be postponed until second and third generations of reform, has resulted in limiting the capacity of the state to undertake key public policy reforms and to accomplish some of its basic responsibilities in terms of the creation of economic infrastructure and the formation of human capital. On the other hand, under democratic governance conditions the poor are empowered, which tends to better ensure that growth is widely, inclusive, and participative. In solid democratic systems, there are more opportunities for the interests of the poor to be represented systematically in the process of formulating and implementing public policies.

Take into account the reciprocal and complimentary relationship between state reform, on the one hand, and strengthening civil society and the expansion of the market on the other. The combination of internal reforms with stimuli derived from a participative and competitive focus, can unleash a virtuous circle of incentives that support the reform process. The role of civil society (labor unions, political parties, non-governmental organizations, academic institutions, business associations, community organizations and other diverse types of society organizations)—for example, in demanding transparency and efficiency in public management in the advancement and consolidation of reforms, the accountability of public officials, and public policies that respond to the general interests of society—is central to the reform process. At the same time, the expansion of the market towards areas that were previously the state's responsibility requires a strengthening of business capacity and accountability to society, as well the development of the state's regulatory capacities in order to avoid inefficiencies and new types of distortions.

Target the basic institutions that shape the incentives guiding the behavior of actors. The projects that are limited to changing instrumental elements or simply strengthening technical organizational capacities, without altering the structure of incentives that affect the political will to apply them, are likely in general to have a negligible impact. Thus, institutional changes that condition the effectiveness of instrumental and organizational reforms need to be addressed at the same time. For example, it does little good to train public employees if their stability and career are not guaranteed through a merit-based civil service like that proposed below. In addition, it does little good to establish a financial management system without the development of a budgetary authority with the professional independence, power and capacity to enforce it.

Avoid the uncritical application of models. The uncritical application of models should be avoided and the specific circumstances of the recipient country should be considered. Even though institutional development historically came about more by imitation than by invention, the success of the transfer of models depends on two factors: first, the consistency of the basic hypotheses regarding the functioning of the reforms within the two contexts; and second, the extent to which the

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

reforms are adapted to the context in which they are applied. In some cases reforms identical to those followed in developed countries have been applied without considering the fact that in the particular countries of the region the minimal conditions necessary for their successful implementation are absent. This is particularly important, given the unequal institutional development existing between the countries of the region. For example, only the countries with more developed institutions, or that have historically incorporated certain attributes of rigor and professionalism, are in a condition to implement reforms that entail greater sophistication and formalization of their management systems; in those countries where de facto informal practices predominate, the approach needs to be more gradual and less ambitious. In these cases it is necessary to identify and give priority to critical institutions and processes whose reform can unleash sustained processes of change and institutional development in the whole state apparatus.

LESSONS RELATED TO THE PROCESS OF DESIGN AND EXECUTION OF OPERATIONS

Ground the operations in ownership by the country, building necessary political will and consensus. The principal problem diagnosed in the execution of the modernization of the state operations is their volatility derived from the lack of commitment of the borrower and/or the opposition of the community. The success of modernization of the state programs and projects requires a clear ownership and commitment of all the actors involved: the state, market and civil society actors, since state reform requires political backing in the whole of society and not only within the institutions that are the object of reform. In fact, experience indicates that the more successful projects are those that emerge from a window of opportunity derived from a crisis or change of government, and whose design has been clearly owned by the borrower. In other words, programs should be directed by demand and not by supply.

Identify and design projects on the basis of a solid knowledge of the institutional situation of the country. Given the technical difficulty of modernization of the state operations and the limited capacities available for their execution, it is indispensable to develop solid analytical foundations on the basis of which to identify and design projects. It is unlikely that the programs and projects will be successful if they do not take into account the complexity of the political situation and the real incentives affecting their implementation. Thus, various information and analytical resources should be available in the process of operation identification, design, and execution: (i) regional and global comparative diagnoses that provide relevant indicators of a country's institutional deficiencies; (ii) institutional diagnoses of countries to support the country strategy of the Bank and serve as an instrument for dialogue and programming; (iii) institutional diagnoses carried out in the course of designing projects that allow the detected problems to be related to proposed measures and the objectives to be obtained; and, (iv) evaluations of projects and country strategies that allow lessons to be learned from past experiences.

Have a comprehensive and long-term conception of reform, but be selective in the definition of projects. One critical aspect of a comprehensive approach is that state reform should cover the entire institutional and legal environment that influence the social, economic and political activity of a country and should not be limited only to the executive branch. Reform processes should be developed in a comprehensive manner and on this basis the Bank's support should be structured in specific operations over time, prioritized according to criteria derived from the urgency of the

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

problems, the viability of available solutions, the existing financial restrictions and particularly paying attention to those operations that can support processes of sustained institutional development within the whole state. At the same time, very large and complex operations that exceed the capacity for execution and the available resources of the countries should be avoided.

Ground execution in specialized and permanent institutions with clear authority to implement the projects. Recourse to ad hoc executing agencies can be unavoidable in conditions with institutional constraints and weaknesses. But, it is important to keep in mind that when such structures tend to multiply and endure longer than necessary they can have negative effects on institutional coherence. In particular, use of such structures in modernization of the state projects should be carefully analyzed, because they can compromise effectiveness in the long term, given that it is necessary for the new practices to be internalized by the permanent units of the state apparatus. In the case that the use of such ad hoc executing agencies proves indispensable, the projects should be designed in such a way that their functions are gradually transferred to regular state agencies.

Design operations to have sufficient flexibility to be able to adapt them to changing situations and, at the same time, monitor them more closely during the implementation phase. Institutional development responds to factors, including political will, the capacity of actors, and the environment in which they act, that are not easily adapted to the traditional schemes of investment and infrastructure operations, or also the rapid forms of disbursement used for supporting the financial situation of governments. In the majority of projects, for example, the uncertainties of the political-administrative context do not adjust well to the rigid separation between design and execution that conforms to the traditional project cycle. The strong dependence of modernization of the state operations on the socio-political environment means that they are subject to constant changes that require a reevaluation of the initial design (hypotheses) and the viability of its proposals for change. In other cases the uncertainty amounts to confronting new situations or those for which there exists little precedent, thus requiring flexibility and the capacity to make changes in midstream. Therefore, the design of operations should consider this flexibility since execution cannot be mechanical. This assumes the advisability of strengthening Bank capacity to carry out the monitoring and evaluation of operations, in close coordination with the borrowing countries and executing agencies, as much to detect unforeseen situations and correct courses of action as to learn from successes and mistakes.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



AREAS FOR BANK ACTION

Given the theoretical and practical evolution described above of the diagnostic of development road-blocks as well as trends faced by the countries, of the lessons learned and of the necessity to coordinate the Modernization of the State Strategy with other basic Bank strategies, the framework document that was approved in 1996 needs to be updated. This updated version maintains the prior conceptual frame-work, in the sense that democratic governance is a necessary condition for development, but at the same time adopts a new and important emphasis for Bank action.

In the first place, this strategy seeks to identify with greater clarity the link between each of the priority areas of action and the sustainable economic growth and poverty reduction strategies (see Annex I). In each of the areas that have possibilities for Bank action, actions that are coherent with that objective are identified.

In the second place, this strategy is different from the preceding version in the manner in which it defines the Bank's priority areas of action. Instead of associating the areas of action to specific institutions or branches of the state, it opts for a transversal definition, based on thematic objectives, whose success requires a more systematic and integrated logic and long-term vision. This focus is justified as the institutional weaknesses that hinder sustainable and equitable growth— such as the lack of legal predictability, corruption, insufficient protection of rights and freedoms, gender and other types of discrimination, weaknesses in macroeconomic management and other public policies and the limited capacity for regulation and supervision, among others— cut across multiple organizations. Priorities ought to be established in relation to the integrated goals of institutional development, whose success involves different branches of the state, together with civil society and the markets.

The cross-cutting nature of the proposed action areas does not entail simultaneous actions in all the branches and institutions of government, rather it means a comprehensive approach to the system that takes into account objectives which go beyond the strengthening of some institutions separately. At the same time, the crosscutting approach should not inhibit action at the level of specific institutions as long as they are inserted into a more comprehensive logic regarding the transformation of the state and its relation with the market and citizens. Nor does it assume that the fields of action should have the same importance in all of the countries of the region. The Bank strategies for each country, based on their needs and specific context, and of the comparative advantages of the Bank, should identify which of these fields ought to be identified as a priority and determine the appropriate sequence for programs to set forth advances in institutional development and democratic governance. As was stated in the lessons learned, it is important to combine a comprehensive approach to the reform process with selectivity and graduality in the definition of operations. Action should be focused on those institutions and critical processes capable of stimulating sustained and generalized processes of institutional development.

A caveat of a methodological nature: the strategy identifies in a disaggregated manner

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

the action areas with the objective of maintaining the principle that reform and modernization of the state requires a comprehensive vision of citizens and the market. The Bank has been accumulating experience and professional qualifications in these areas, without reducing the need to work in coordination with other development agencies. The importance of appropriate coordination with other bilateral and multilateral agencies should be emphasized with the objective of implementing this comprehensive vision of state reform. The special comparative advantages of the Bank in some fields should be complemented with those that other cooperation agencies have in other areas. The identification of the areas of action and their disaggregation, are a menu of options available to the Bank and the member countries. It is not a matter of doing everything in all the countries, rather at the country level, and in accordance with the services that the Bank offers and the particular needs and circumstances that each country faces, priorities for Bank action ought to be established. In this sense the country strategy and the implementation of Bank operational programming are instruments that coordinate this strategy and Bank activity in each country.

The strategy outlines, through its focus on priority areas of action, the basic institutional requirements of democratic governance in light of the general goals of sustainable growth and poverty reduction. These requirements are compatible with the different options that the countries can legitimately choose in respect to the role for their respective states in relation to the market and civil society. In other words, the strategy does not have as objective to identify in an a priori manner the role of the state, prioritizing some functions (for example, regulation) and rejecting others (for example, promoting investment or engaging in production). Experience demonstrates the desirability for states to maintain the option of as wide as possible a portfolio of possible functions, choosing those in which to concentrate based on their specific circumstances and institutional, economic, social, cultural and political factors. The following section describes these areas of action in greater detail and identifies the specific actions and programs that the Bank could develop to support the countries of the region: A) Democratic System; B) Rule of Law and Justice Reform; C) State, Market and Society; and D) Public Management.

DEMOCRATIC SYSTEM

The achievement of sustainable and equitable growth in the region depends on the simultaneous pursuit of two interdependent objectives: on the one hand, the attainment of increased democratic political stability and on the other, a greater political inclusiveness which permits an effective representation of large sectors of the population that are presently excluded or unequally represented.[1] Both aspects are closely related, as long-term democratic political stability cannot exist without the effective integration of all sectors of the population in the system of political representation, in such a way that excluded sectors influence the design and implementation of public policies so that they respond to the common good. Inclusion ought to avoid logics that increase the particularism and volatility of the political system, which entails strengthening representation based on the general interest. The Bank can support the countries with programs and projects in the following areas:

Strengthen the institutional capacity of the legislative branch. This should be carried out

[1] To that effect, all the structural factors of exclusion whether the result of gender, ethnicity, culture or of whatever other type, should be considered included in the strategy. They haven't been disaggregated in a specific fashion in order to avoid overloading the text and to facilitate reading.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

under the principles of contributing to an effective separation of powers and strengthening of democratic representation, especially for the excluded groups. The legislative branch is one of the institutions that is most important to the interrelationship between the state and society. At the same time, it also carries out key functions, both in drafting and enacting legislation and in overseeing the executive. The Bank can contribute to the modernization of the legislative branch by supporting programs designed to: (i) strengthen technical assistance systems that will improve the quality of legislation and help ensure that budgetary, monitoring and oversight functions are performed based on objective and technical criteria; (ii) modernize legislation to eliminate obsolete laws, incorporate into the national legal framework commitments stemming from international treaties and conventions, address challenges resulting from technological change, globalization, new forms of delinquency and organized crime and overcome all types of exclusion; (iii) establish a professional parliamentary organization and administration, including systems that guarantee accuracy in the recording of legislative debates and laws and registering of roll call votes, as well as the installation of modern systems of public information, documentation and legislative reference, including electronic connection with other legislative libraries; (iv) develop channels for dialogue and communication between the legislative branch and the population, especially those that are designed to favor voice and participation of excluded sectors and to define policies for poverty alleviation; and (v) develop technical and policy training programs for political leaders and parliamentary groups with the objective of strengthening democratic political leadership and the political party system.

Modernize the electoral and party system. The objectives should be oriented toward the improvement of representation, avoiding the exclusion of sectors of the population, especially the poorest. Modern democracy requires effective electoral systems and political parties that serve as a link between the state and citizens, stimulating participation, articulating demands and aggregating different social interests. The Bank can support the following: (i) establishment of independent, reliable and technically capable electoral institutions, including support for voter registration and information systems. Special attention will be paid to information and outreach systems that promote the electoral participation of illiterates and communities that have traditionally been excluded; (ii) strengthening of political party systems through technical assistance to legislative agencies and electoral authorities to adjust the legal framework of their constitution, functioning and financing and for the development of democratic political leadership training programs.

Ensure the neutrality and objectivity of public administration. In addition to the powers of direction and supervision that correspond to democratically elected governments, an effective democracy requires a neutral and capable administration able to serve governments with different political orientations. In addition it should guarantee, from a professional perspective, the continued delivery of public services and attention to the permanent duties of the State. To this end the Bank could support: (i) fair, merit-based hiring and promotion practices within public administration, such as prohibiting the arbitrary removal of public officials; (ii) promoting an ethical code among the permanent civil servants to strengthen their commitment to the values of neutrality, objectivity and defense of the common good; (iii) the delineation of political and administrative functions, as well as the systems for the articulation between them, through planning and control mechanisms; (iv) the existence of systems that allow for the effective protection of citizen rights before the

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

actions and omissions of public administration, through judicial mechanisms or alternative, ombudsman-type mechanisms; and v) the transition processes between governments and the establishment of systems that guarantee the integrity, transparency and permanence of administrative information.

Strengthen inspection, oversight and supervision agencies. The objective should be to ensure transparency and honesty in the activities of government officials and in state transactions and management. In this context, oversight and corruption fighting institutions have acquired great importance. The Bank could provide support to: (i) increase the technical capacity and functional independence of institutions that oversee government performance, for example the offices of the comptroller general, court of accounts, auditor general, ombudsman, public defender, public prosecutor and attorney general; (ii) design and implement mechanisms for public management oversight by civil society organizations such as consumer advocates and civil auditors, with the objective of increasing transparency and avoiding bias; (iii) incorporate into national legislation international conventions and commitments that support the fight against corruption and review legal and administrative legislation with the objective of avoiding conflicts of interest and promoting greater transparency and information on the activities and transactions of the state, including implementing accountability, disciplinary and justice systems.

Support the processes of decentralization of political power and democratization of subnational governments. The objective is to bring representation closer to the citizens and the communities to which they belong. These processes ought to pay attention to overcoming the observed institutional deficiencies derived from the "capture" of subnational administrations by local interests, fiscal indiscipline, inefficiency in the provision of public services and the scarce coordination between community organizations and the decentralized levels of public management. In this framework, the Bank will support: (i) the development of decentralization processes, paying attention to fiscal implications and protecting the balance of authority and accountability between the different levels of government; (ii) the establishment of a normative and institutional framework for decentralization that clarifies the division of responsibilities between levels of government in order to promote the allocation of resources toward socially valuable ends; (iii) the promotion of the democratization of subnational governments, ensuring representation and oversight mechanisms that are in accordance with democracy, transparency and accountability. This entails the necessity of integrating marginalized zones and bringing decision-making closer to citizens, including support to political-administrative entities linked to indigenous communities in countries that have recognized them; and (iv) promotion of civil society incorporation in the elaboration and implementation of local policies through participation mechanisms that take advantage of their capacity to articulate public interests.

Strengthen the participation of citizens in the formulation and implementation of public policies. In coordination with the governments, as primary interlocutors for the Bank, citizen participation in public policy formulation and execution in the countries and in the development of projects and programs will be promoted. At the same time, the strengthening of the democratic system, which is one of the central of objectives of this strategy, will enable a greater role for citizen participation in public sector management. In this direction, the Bank can support: (i) implementing programs to strengthen the institutional capacity of relevant civil society organizations for project design and execution, especially with regards to technically weak organiza-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

tions; (ii) designing operations with components that could be carried out by civil society organizations; and (iii) establishing participation channels for beneficiaries in the design, execution and evaluation of programs.

Promote a democratic culture in the citizenry. Consolidation of democracy requires a political culture based on ethics, values and a democratic civic culture. The Bank can support the: (i) incorporation of civic education programs in reform, expansion and strengthening of the formal education system projects; (ii) promotion of educational courses and reforms designed to encourage a culture of tolerance, freedom, participation, accountability and social solidarity.

RULE OF LAW AND JUSTICE REFORM

It is not possible to advance sustainable and equitable growth without progress in legal predictability and equality before the law for all citizens. The development of investment and assumption of risk that form the basis of market economy development, are incompatible with the uncertainty or slowness that is observed in the region regarding the protection of rights and obligations. On the other hand, an important part of the population, especially poor and excluded sectors, lack legal predictability with regard to their assets, and therefore have limited access to credit and formal systems of work and production. Other manifestations of the weakness of the rule of law are the impunity with regards to corruption and the elevated rates of citizen insecurity. Bank action in this area ought to be directed towards developing a justice system that is independent, efficient, reliable, agile and accessible, without discrimination based on race, gender or of any other type, for which programs and actions could be oriented toward:

Support the independence of the judiciary. Judicial independence means that the availability of budgetary resources, appointments, recruitment and career development of judges and magistrates and cooperation with other judicial institutions are not exposed to interference by political or economic interests that can compromise the objectivity and independence of judicial decision-making. With this objective, the Bank can support programs that involve the following, among other activities: (i) creation or strengthening of institutions of the justice system to ensure their independence; (ii) establishment of systems for the recruitment, career development, training, disciplinary action, and remuneration of judges and magistrates that will guarantee the principles of equality and merit; and (iii) strengthening systems that promote the accountability of the judiciary to citizens.

Widen access to justice. The objective should be to widen access to justice for those segments of the population that are marginalized for geographic, socioeconomic, ethnolinguistic, gender and other reasons., and. Accordingly, Bank support may include: (i) the establishment of public defender systems and free legal aid services and other mechanisms that widen access to justice; (ii) modernization of judicial procedures to decrease barriers and access costs, including normative simplification; and (iii) the design and execution of programs for outreach and training in basic citizen's rights.

Strengthen the capacity of the judicial system in the fight against corruption. As legal sanctions are the most effective form of dissuading corrupt behavior on the part of public and private actors, the Bank could support the: (i) creation of specific units to fight corruption in the attorney general and the public prosecutor's offices; (ii) adoption and implementation of necessary legal instruments by the countries, including conventions and international treaties for the fight

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

against this type of crime; and (iii) the development of instruments for transparency that strengthen oversight by citizens and civil society organizations.

Develop modern systems for management and administration of judicial institutions and procedures. The ineffectiveness of judicial system management and processes, the weakness and limited coverage of the registry of property and people (there are wide segments of the population that lack property titles), are the causes of legal unpredictability, the denial of rights and socioeconomic exclusion, that limit the possibilities for a dynamic and equitable growth. Bank actions could include: (i) modernization of the administration of justice, including the design of new accountability frameworks in order to manage judge's offices and procedures more efficiently; (ii) reform of administrative structures, procedures and processes and the creation of modern methods of planning, human resource management, information systems, and training, and the establishment of an appropriate system of judicial statistics; (iii) expansion and modernization of the physical infrastructure of courts and tribunals to increase the coverage of the judicial system and to support its improvement; and (iv) development of programs that modernize and widen the coverage of the registry of people and property, including registry projects for urban and rural property, paying special attention to informal and excluded sectors.

Promote alternative conflict resolution methods. Alternative conflict resolution methods help reduce case backlogs and broaden access to justice. In this regard, the Bank may support: (i) the establishment of mechanisms to bring the law closer to the community to decrease the level of litigation and help reduce court congestion, including justices of the peace and other types of customary justice; (ii) the creation of opportunities to resolve conflicts through arbitration, mediation or conciliation; (iii) the promotion of basic civic and legal education regarding judicial institutions, court proceedings, and basic citizen rights, including training in alternative conflict resolution methods in schools and civil society organizations; and (iv) the capacity of special indigenous jurisdictions recognized in the legislation of some of the countries of the region.

Update substantive and procedural legislation. Actions in this field could include the: (i) elaboration of new laws and their regulation to respond to changing social needs; (ii) codification of existing laws prior to their simplification and streamlining; (iii) modification of procedures that would ensure an expedited exercise of rights and an effective and opportune compliance with obligations, such as a greater access to justice; (iv) modernization of judicial systems in order to promote convergence and coherence with regional norms to support the processes of economic integration.

Protect citizen security, and ensure the legal control of the use of force. In this area, Bank projects will seek to make human rights protection and procedural guarantees compatible with the need to combat violence, criminality and impunity that undermine the investment climate and impose a cost on citizens, especially the poorest. This section continues with the advice contained in the preliminary guidelines for project preparation for violence reduction in the countries.[2] Bank activities in this area can include: (i) strengthening the offices of the public prosecutor, ombudsman, and attorney general and formulating crime prevention policies; (ii) the establishment of rehabilitation and alternative sentencing programs to reduce recidivism; (iii) training, equipping and providing infra-

[2] CP-2190-2 "Preliminary Guidelines for the design of violence reduction projects".

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

structure to support forensic medicine and professional investigative practices; (iv) computerizing criminal statistics and establishing criminal information and record systems; and (v) strengthening executive branch institutions in charge of ensuring the state and legal monopoly of the use of force, as well as civilian control of the armed forces and the police.

STATE, MARKET AND SOCIETY

The market is an area of the economy whose widening and improving depends on sustainable growth and an effective fight against poverty. Market development has been very uneven among and within the countries in the region: major segments of the population and property remain outside the market economy, and rent-seeking situations persist, which limit the development of productive capacity. It is necessary to develop government institutions and public policies that will provide the essential conditions and incentive systems conducive to the efficient and competitive operation of a market economy, which is a core requirement for dynamic growth and job creation, in a context of increasing worker productivity. For markets to function well, it is essential to guarantee a stable macroeconomic and financial framework that offers certainty to economic actors. At the same time, the reforms necessary to improve and widen markets with the two-pronged objective of increasing their efficiency and inclusiveness cannot be achieved without implementing wide partnership mechanisms between the different economic and social agents. The development of wider markets, that favor the inclusion of sectors of the population that are at present excluded, but that are also more efficient and capable of competing in the global economy, is the double objective of the policies and institutions that are referred to in this section. In this context, the following possibilities are open for Bank action:

Support the professionalism of the economic management institutions. As indicated in the Sustainable Economic Growth Strategy, the achievement of a stable macroeconomic framework requires the existence of institutions with sufficient authority, competency and capacity to obtain this objective. This assumes the need to support the development of legal regimes, personnel statutes and management instruments that allow the above-mentioned authorities to carry out their functions in a manner that is coherent with the objective of a stable macroeconomic framework. In particular, the Bank will support the institutional reform and development of: (i) monetary authorities; (ii) entities in charge of financial supervision and authorities responsible for pension system management; (iii)budgetary and tax authorities and iv) authorities responsible for statistic maintenance and census collection.

Improve social and economic regulatory agencies. In order to promote market competition and safe-guard the public interest as well as vulnerable groups, it is necessary to strengthen and improve economic and social regulatory agencies. The institutions that regulate markets carry out at least the following crucial functions. First, they establish and ensure the effectiveness of property rights and contractual entitlements. Second, they help channel information on market conditions, actors, and participants, thereby ensuring a more informed and transparent decision-making process. Third, they increase market competition, which has an impact on the equality of opportunities, efficient resource allocation, and innovation. Lastly, they protect against negative externalities that can result from market forces, for example with regards to protection of the environment, vulnerable groups and consumer rights. In these areas, the possibilities where the Bank could provide institutional support include: (i) modernizing commercial, financial, and procurement legislation and streamline administrative regulations and

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

procedures to avoid an adverse impact on competitiveness; (ii) promoting data instruments that ensure transparency; (iii) strengthening the independence and professionalism of the regulatory institutions, including their accountability mechanisms, supporting their consolidation when beneficial and developing complementary institutions necessary to be effective; (iv) modernizing economic regulation procedures, promoting transparent and efficient processes; and (v) developing norms and the institutions and procedures to protect consumers, including those that are supported by the participation of social groups.

Support institutions that design and promote active and inclusive development policies. In accordance with the Competitiveness and Social Development Strategies, the Bank will support the: (i) establishment of institutions and agencies that promote economic development, as much at the national as at the subnational levels, that widen opportunities for all sectors and regions, paying special attention to those that are most vulnerable and excluded; (ii) institutions in charge of promoting the expansion of physical infrastructure and increase of human capital; (iii) the institutions that support the formalization of economic activities, especially with regards to small and micro enterprises and simplify the recognition of contractual rights and obligations; and (iv) institutions for the development of collaboration mechanisms between the public and private sectors and civil society in the public policy formulation process.

Support the establishment of socioeconomic partnership institutions and instruments. For the design and implementation of the reforms necessary for the improvement and widening of markets, the Bank can support: (i) the establishment, reform or modernization of consultative forums that incorporate the different economic and social actors, and their institutional strengthening, and the design and implementation of horizontal and sectoral social partnership mechanisms to stimulate economic and other types of reform and; (ii) social partnership with communities and groups particularly those whose relation to and dependence on natural resources is critical for their subsistence and development.

Improve environmental governance. The institutional framework that the countries adopt is critical for the development and introduction of an environmental agenda geared toward an efficient and effective management of environmental resources. In this area the Bank could support: (i) the strengthening of intersectoral coordination in such a way that the dimension of environmental governance is included in the handling of the diverse productive sectors; (ii) the strengthening of central environmental protection institutions and the regional and local capacities for environmental management; (iii) the development, in accordance with the Environment Strategy, of regulatory instruments that establish a balance between the distribution of costs and benefits of conservation and environmental control; (iv) the participation of civil society, especially traditionally underrepresented groups, in the decision making processes for the use, protection and conservation of resources.

PUBLIC MANAGEMENT

Sustainable and equitable growth depends also on the quality and efficiency of public policies and management. As experience in the region has shown, without public policies that are fiscally responsible and sustainable, macroeconomic stability will be affected, undermining efforts for the development of production and poverty reduction. Strengthening accountability mechanisms provides incentives for efficiency in public policies and management and constitutes as much the best preventative measure against fiscal imbalances, as the only way to satisfy

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

social and economic needs that are indispensable for promoting sustainable and equitable growth. A particular priority is to adapt resource allocation systems so that they respond to the needs of the disadvantaged and adapt public service provision systems, enabling participation and direct involvement. In order to achieve the above, it is indispensable to overcome the politization of public administration and its "capture" by particular interests, that results in the phenomena of clientalism and cronyism that are the causes of inefficiency, corruption and distortion of state actions and policies. Public administrations ought to form the institutional platform for the formulation and implementation of public policies that respond to the common good of society, with complete subordination to the law. In the area of the strengthening of public administration and the processes of design and implementation of public policies, the possibilities for Bank action are the following:

Develop and strengthen civil service systems according to principles of merit and flexibility. The Bank will support the development of policies, regulations, and institutions that support a modern and competent civil service, based on the principles of merit and equality. The Bank could support, among others, the following activities: (i) institutionalization of a merit-based and modern civil service, as a way to professionalize public administration, incorporating a modern legal system adapted to the current needs of public administration; (ii) development of modern and efficient human resource management policies and systems, including those regarding the selection, promotion and evaluation of personnel, adapted to the current needs of public services, with diverse methods of hiring and employment; (iii) coordination and coherence between public salary policy and fiscal policy, given the extraordinary interdependence between both due to the proportion of the cost of public employee salaries; (iv) development of information systems and human resource management that consolidate necessary information, allowing for a responsible management of public employment integrated with budget management; (v) support to an appropriate dimensioning of the workforce in public administration, following the criteria and approach of strategic streamlining; (vi) modernization of pension systems of public employees; (vii) support to training of public employees, as long as it is tied to objectives that improve service provision or to well defined human resource policies; (viii) development of the management capacity of the governments through the institutionalization of a professional career path subject to a performance based system, with incentives of the same nature.

Strengthen the fiscal capacity of the state and improve the efficiency and transparency of expenditure management. It is necessary that the state have sufficient resources so that it can provide public goods that are essential to be able to finance a modern and competent public administration and strengthen the position of the countries faced with recurring external shocks. To this regard, and in accordance with the Sustainable Economic Growth Strategy, the Bank should focus its efforts toward aligning the fiscal capacity of the countries with their development needs according to the criteria of transparency, equity, sustainability, and non-distortion of market forces. At the same time, it is necessary to guarantee fiscal discipline and better management and oversight of government performance through proper transparency and by providing quantitative and qualitative information on the provision of public goods and services and the evaluation of expenditure efficiency. In this sense, Bank action can be oriented toward: (i) supporting reforms that increase revenue by strengthening collection agencies, procedures, and systems, including the modernization of customs agencies and simplification of legislation and tax proce-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

dures; (ii) strengthening the fight against tax evasion; (iii) supporting the development of the legal and institutional frameworks necessary for fiscal balances and accountability, including aspects such as tributary and expenditure monitoring; (iv) implementing comprehensive financial and accounting management systems and promoting the transparency of budgetary information; (v) developing comprehensive performance-based budgetary systems that permit the targeting of resources to more efficient activities and the focusing of policies on the neediest sectors and regions; (vi) supporting the decentralization of budgetary power to executive units or agencies that are closest to service provision, with the establishment of performance-based monitoring and evaluation systems especially with regards to those units and programs designed to impact poverty and inequality levels; (vii) strengthening the budgetary offices of the legislative branch so that they have sufficient technical capacity to elaborate and monitor budgetary norms; and (viii) developing modern public purchasing and hiring systems, that are integrated into budget management and allow for maximum transparency, rigor, and competitiveness in acquisitions, and use the potential that the new information and communication technologies offer.

Improve the capacity for the formulation and coordination of public strategies and policies. This should especially consider the protection of macroeconomic stability, the fight against poverty, and the promotion of equity and regional integration. The governments face growing challenges at a time when they must coordinate needs with available resources, especially in the above-mentioned areas where the coordination of a large number of governmental and non-governmental actors is necessary. The Bank can back the development of these capacities through support to the: (i) strengthening of the institutional capacity to formulate public policies that are appropriately coordinated with each other, including the implementation of coordination systems between the legislative and executive branches; (ii) establishment of strategic evaluation systems, including the development of data collection and analysis capacity for the elaboration and evaluation of policies; (iii) implementation of instruments to prioritize investments; (iv) establishment of effective systems for monitoring and evaluating public policies, especially those that combat poverty; and (v) modernization of state institutions responsible for the coordination, planning and execution of poverty fighting policies, including their institutionalization as State policies.

Modernize public services management systems. This should aim to make public services more receptive to the demands of citizens, especially with regards to the sectors that have been traditionally excluded. Management of public services can be carried out under a varied range of institutional mechanisms. The role of the State (with its different levels of government), market, and civil society can be combined in the various functions of planning, regulation, financing and production. Given that there are no universally valid forms of service delivery, in each case the best alternative must be selected based on the existing circumstances. The Bank will support the countries in establishing management models that create the greatest incentives for quality and efficiency including the: (i) establishment of executive agencies and entities under a performance-based management system; (ii) creation of unified offices (one-stop windows) for the provision of services; (iii) improvement in the targeting and management of programs designed to eliminate poverty; (iv) use of the market and civil society organizations (contracting, concessioning and outsourcing) for the production and financing of services when this would provide the best results; (v) the strengthening of sectoral capacity to define

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

policies in cases of decentralization or indirect provision of services; (vi) development of capacity to oversee service provision; (vii) transfer of power to subnational governments, development of horizontal and vertical intergovernmental instruments to promote economies of scale for the provision of services and correction of regional imbalances through the coordination of multi-sectoral actions; and (viii) development of the institutional capacity of subnational governments to provide public services effectively and efficiently, including the availability of a professional civil service, a strengthened fiscal capacity through the ability to collect revenue locally and the existence of a framework for budgetary discipline and fiscal co-responsibility on behalf of the regional entities.

Use the potential of the knowledge and information technologies. Modern information and communication technologies are closely linked to the process of state reform. On the one hand, there are instruments to carry out the transformation of the public sector. On the other, the growth of the so-called knowledge and information economy is becoming the focus of public policies. The majority of the countries of the region have still not adopted a model for the development of a comprehensive and duly articulated society that has broad technological capacity, incorporating the vision and needs of the state, the private sector and civil society. There are often widely disbursed initiatives in the sector, duplication of efforts and resources, and an absence of coordination between the public, private and academic sectors. Given this situation, institutional, regulatory and organizational conditions need to be established that will favor a participatory focus in the definition of agreed-upon objectives and duly coordinated responsibilities. In this regard, the Bank will support: (i) the definition and implementation of strategies to develop an information society; (ii) the strengthening of public institutions governing the information society and e-government; (iii) the development of legal requirements and infrastructure to support the technological development and innovation, with emphasis on internal and external connectivity nationwide; (iv) placing public services online in order to achieve tangible improvements in accessibility, efficiency and transparency; and (v) the establishment of cooperation channels between the public and private sector to expand the information society and e-government.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

OPTIONS FOR BANK SERVICES AND IMPLEMENTATION GUIDELINES



For implementation of the strategy, the Bank has several instruments at the level of each country and at the regional and sub-regional levels. Several of these instruments have recently been updated and reconfigured, such as the creation of flexible lending instruments, the adoption of new guidelines for country papers (now called country strategies), as well as the possible creation of new financing instruments currently under review. Although these instruments and services have not been exclusively designed for Bank action in the area of modernization of the state, these changes are positive for the implementation of this strategy. As will be demonstrated in the continuing section, the Bank presently has instruments available that are highly adaptable to the requirements of change and institutional development.

First, at the national level, Bank action will contribute to the formulation of development strategies and policy for the countries through the following instruments:

i) The Bank strategies for each country, in which Bank operational strategy is defined in a country for a set period of time and programmatic guidelines for Bank dialogue with national authorities, are determined. As noted above, these strategies and the exercise of programming in each country are the most important instruments to articulate this strategy— with their wide and diversified supply of topics— with the particular needs and circumstances of each country. The criteria for prioritizing Bank action, as well as the identification of the areas in which the Bank has a comparative advantage should be deduced from the particular characteristics of each country. In the same manner, these country strategies should serve to identify those fields in which the Bank should work in closer coordination with other development agencies.

ii) The national strategies for poverty reduction, which, in addition to their intrinsic content, consolidate the groundwork for improved coordination and linkage with other multilateral financial institutions and bilateral aid agencies, in the countries in the region that most urgently need external support.

iii) The sectoral studies that support the formulation of Bank strategies for each country and for poverty reduction by analyzing critical problems and identifying priority areas of action in accordance with the individual characteristics of each country. Within this topic, the critical importance of diagnostic studies of public sector institutional capacity has been recognized.

iv) The institutional diagnostic studies, and in particular together with other international cooperation agencies, analytical work that results in a comprehensive vision of the institutional problems of the countries (like the Country Financial Accountability Assessments and Public Expenditure and Management Reviews).

v) The policy dialogues at the national level, in as much as they help identify lessons learned, exchange experiences, structure specific development agendas, and build consensus.

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

Second, Bank financial instruments have gradually become more diversified, in such a way that investment loans, sector loans,[3] and national technical cooperation programs have opened new opportunities to support institutional development. Below, it is suggested that the use of different types of instruments, in coordination with baseline sectoral studies and country strategies, will be of particular importance for the implementation of this strategy and for deepening and making more effective Bank action in this field.

On the other hand, at the regional level, the Bank has nonfinancial instruments that include regional technical cooperation programs, which address high priority issues in borrowing countries' agendas and allow research, dissemination, training, and consensus-building activities to be carried out. The Bank also has regional policy dialogues with policymakers in the borrowing countries help identify lessons learned, exchange experiences, and structure specific development agendas. Additionally, the Bank has non-financial instruments applicable to this field, such as the policy documents, sectoral guidelines, lessons learned and best practice studies, and sectoral analysis studies, among others.

A review of the instruments available to the Bank to implement the Modernization of the State Strategy led to the following observations:

i) Strategy implementation will provide opportunities to strengthen diagnostic studies, regional and national dialogues, country strategies, and to coordinate the Bank's financial and non-financial products in the field of modernization of the state.

ii) The success of this strategy depends both on the availability of necessary instruments and their proper selection in each situation and on how these instruments are coordinated with each other. For example, complex institutional modernization operations can be approached through initial stages of analysis, consensus building and the development of basic institutional capacities that can be financed through technical cooperation programs and through flexible lending instruments[4], allowing for subsequent traditional sectoral or multiphase loans of greater magnitude. In addition, given the nature of the institutional changes required by the countries, it is estimated that multiphase operations will be frequently used as a way to support the reform process and consolidate long-term Bank support.

iii) The elaboration of modernization of the state operations tends to be more complex than other types of projects and frequently requires activities that are not considered in the "traditional" project cycle. Even though the Bank has a broad and expanding range of financial instruments, experience has shown that some of them have limitations. As a result, it is considered necessary to intensify the use of resources from trust funds. Similarly, use of funds from the Multilateral Investment Fund (MIF) is recommended when possible and consistent with its mission (as has been the case with the MIF operations to support the establishment of Arbitration and Alternative Conflict Resolution, or the establishment of regulatory frameworks appropriate for the private sector).

iv) There is a need to evaluate the experience in the use of different Bank instruments

[3] Within the investment loans, at present there are the "flexible lending instruments" that include: innovation loans, support to project preparation and execution facility, multiphase program loans and sectoral facilities among which there is a specific one for institutional development.

[4] Particularly with regards to the innovation, the project preparation and execution facility and the sector facility loans.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

in modernization of the state programs on an ongoing basis. The reform process tends to be complex and therefore often requires institutional, technical or management capacity for change, which is absent from the affected institutions. Consequently, it is necessary to combine traditional or sectoral loans, for example with technical cooperation programs, and draw general lessons from this critical aspect.

v) The implementation of this strategy offers great opportunities to improve the methodology used in the preparation of projects, with the purpose of ensuring the evaluability of operations among other objectives.

vi) In the implementation of the strategy, an effort will be made to ensure closer cooperation with other international development agencies that are working in the field of modernization of the state, in order to maximize joint efforts, avoid duplication and conflicts and strengthen synergies. The coordination of Bank action with bilateral donors, who have increasingly been incorporating democratic governance into their aid agendas, offers a great potential to increase the efficacy of projects in this field. To take advantage of this potential cooperation it would be useful to focus coordination efforts on the initial stages, such as in the preparation of analytical and diagnostic studies on institutional capacity.

To implement the Modernization of the State Strategy, a set of actions whose general objectives are to strengthen the relation between the priorities and criteria contained in the strategy and programming activities of Bank operations in each country, as well as with the design of the Bank's financial and non-financial products. For reasons noted above, it is considered especially important to coordinate this Strategy with the country strategies since Bank action should be grounded in the demands of the countries, in accordance with their particular circumstances, and not with preestablished models. In particular the following activities are proposed:

- Analyze institutional capacity in the countries based on governance indicators that facilitate the identification of regional and national priorities and serve as a baseline for future evaluation.
- Incorporate the institutional capacity studies in the country strategies with the objective of identifying priorities for Bank action and providing a baseline for evaluation purposes. This task is essential for enhancing coordination between this strategy and Bank action in each country.
- Elaborate technical notes for identifying and improving pertinent outcome and impact indicators in the activity areas of this strategy in collaboration with other international institutions.
- Elaborate operational guidelines to orient Bank action in the four activity areas identified. Each guide would incorporate the necessary methodologies, procedures to follow, decisions that need to be made and responsible public agencies.
- Examine the possibility of a regional policy dialogue with those officials responsible for modernization of the State in the borrowing Bank member countries.
- Deepen the cooperation of the Bank with other multilateral institutions and development agencies to exchange knowledge and experience on the topic of modernization of the state, as well as to implement joint initiatives in respect to diagnostic studies and evaluations of actions in this field.
- Strengthen Bank participation in regional networks that work on the topic of modernization of the State.
- Develop professional profiles in the Bank to generate the necessary capacity that the implementation of this strategy

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

requires, through dissemination to Bank officials of the Modernization of the State Strategy. Special attention should be paid to the needs of country office staff, who have the responsibility of continuously monitoring projects and making adjustments when changes in circumstances require it.

The Bank has been strengthening its professional capacity to support the countries in the field of reform and modernization of the state. The establishment in the Regional Operation Departments of divisions specialized in the topic has been a significant step in this direction. Coordination and exchange of experiences between these divisions and with the Central Departments through thematic networks of specialists from the different action areas of the Strategy will be reinforced. At the same time, coordination with the Country Divisions will be strengthened so that the country strategies and the programming exercises reflect the institutional reform priorities in the countries. Likewise, cooperation between the central departments of the Bank that carry out the activities of data collection, analysis and knowledge exchange regarding the topic of modernization of the state will be strengthened.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

MONITORING, EVALUATION AND PERFORMANCE INDICATORS



Monitoring and evaluation of the Modernization of the State Strategy will be carried out through output, outcome and impact indicators. Monitoring and evaluation are fundamental instruments for this Strategy's implementation and for the specific operations that are formulated accordingly. In compliance with existing policies and norms, the loans and technical cooperation programs that are carried out within the scope of this strategy should specify clear goals and objectives and include measurable indicators fixed to a baseline.

OUTPUT INDICATORS

These indicators measure Bank activity in the area covered by the strategy: (i) number and amount of loans for modernization of the state and each area activity defined in this strategy; (ii) number and amount of technical cooperation programs; (iii) number of institutional diagnostic studies carried out; (iv) number of country papers that include a diagnostic of institutions and governance; (v) number of best practices studies on Bank operations; (vi) number of events disseminating best practices; (vii) number of operational guidelines created; (viii) number of dialogue events with each country and with groups of countries in the region; and (ix) number of studies evaluating the final impact of Bank projects and actual achievement of the project objectives. In particular, it is proposed to complete the institutional diagnosis for all countries by December 2006.

OUTCOME INDICATORS

The purpose of these indicators is to evaluate the outcome of modernization of the state projects based on project execution reports, project completion reports, and project alert identification systems. To this end, projects following the methodology set forth in the logical framework should identify outcome indicators based on objectives connected to the activity areas identified in this strategy. As part of the work plan for implementation of this strategy, a technical note with outcome indicators in the strategy activity areas will be made available to the operational divisions. It should not be forgotten that in order to make this evaluation possible during the preparation of a project, it is necessary to carry out a baseline analysis that measures the country's situation in relation to these objectives.

IMPACT INDICATORS

The purpose of these indicators is to evaluate the progress made in meeting the final objectives of the Modernization of the State Strategy in each of its activity areas. Impact measurement should be carried at the country level in accordance with the goals regarding governance and institutional development that have been included in the Bank strategy for each country. The intrinsic difficulty inherent in this type of evaluation should be taken into account however, since governance and institutional development in a particular country depend on a set of factors that go beyond the impact of the Bank's modern-

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

ization of the state projects. Given the importance of these exogenous factors, which frequently have a predominant effect, it can be hard to attribute observed changes in the action areas to which this strategy refers.

Additionally, the definition of relevant governance indicators is still in a very early stage of development. Only partial indicators compiled by different entities are available and although relevant, their reliability is very inconsistent. Among others, available indicators include Latinobarometer's confidence and satisfaction with democratic institutions, Transparency International's corruption perception indicators, and the indicators regarding the efficiency of public administration, the rule of law and quality of regulations and public environment for markets developed by the World Economic Forum, among others. The Development Assistance Committee (DAC) of the Organization for Economic Co-operation and Development (OECD) is promoting the identification of second-generation governance indicators that will meet relevance, political viability and objectivity criteria that can be applied with greater precision to diagnostic studies and strategies designed to improve governance. The Bank is participating in the development of this effort through the multilateral coordination group with the objective of benefiting from the advancements on this topic. Not withstanding their limitations, impact indicators are considered essential to assist countries and international development agencies with the monitoring of governance and institutional situations in the region's countries. In order to advance the work in this sector, a tentative impact indicator proposal corresponding to the activity areas defined in this Strategy will be made available to the Bank's operational Divisions.

The implementation of this strategy will depend on the priorities that the countries establish, the circumstances that they face and available resources. An evaluation of the implementation of the strategy that distinguishes between the action areas that are the responsibility of the Bank and those that are the responsibility of the countries and/or other exogenous factors, will be carried out after five years of being in effect.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ANNEX



Areas of Action for the Bank and their Relation to the Sustainable Economic Growth and Poverty Reduction Strategies

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
A. Democratic System	**Consolidation of the democratic system**	**Democratic system and political inclusion of the poor**
Objective: Greater political stability and a better environment for investment and growth. Better representation of the poor and excluded sectors in the formulation and execution of public policies.	*Objective:* Political stability.	*Objective:* Political inclusion.
Sub-sections:	*Actions:*	*Actions:*
• Legislative branch	• Modernization of the legislative branch.	• Strengthening of internal mechanisms of parliaments to favor the voice and participation of marginalized groups and the definition of policies to reduce poverty.
• Electoral and party system	• Modernization of the electoral system.	• Modernization of the electoral systems to include poor and excluded citizens.
• Public administration neutrality	• Stability, continuity and efficiency of public servants.	• Efficiency and continuity of policies and services for the poor.
• Supervisory and monitoring institutions	• Effective functioning of supervisory and monitoring institutions.	• Transparency in public management to improve allocation of resources.
• Decentralization of political power	• Regional economic development.	• Decentralization to integrate marginalized zones and bring decision-making closer to those affected.
• Civil society	• Strengthening of economic actors.	• Strengthening of the capacity of community organizations to fulfill their role in a decentralized context.
• Democratic culture	• Promotion of democratic values among social actors.	• Promotion of values of democratic inclusion.

(continued on the next page)

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
B. Rule Of Law	**Strengthening of the rule of law**	**Rule of law and the access of the poor to justice**
Objective: Greater legal predictability, indispensable for investment and growth, and greater coverage and access to justice, especially for the excluded sectors.	*Objective:* Legal predictability.	*Objective:* Effective acknowledgment of the rights of the poor and marginalized groups.
Sub-sections:	*Actions:*	*Actions:*
• Judicial branch	• Independence of the judicial branch.	• Independence for the judges and magistrates for the the protection of the effective rights of the poor.
• Access to justice programs	• Reduction of transaction costs.	• Effective access for the poor.
• Anti-corruption programs	• Overcoming of institutional weaknesses that favor corruption.	• Eradication of corruption as a cause of income redistribution to the detriment of the poor.
• Judicial management and administration	• Modernization of the justice administration.	• Reduction of the costs of access for the poor.
• Alternative conflict resolution measures	• Alternative conflict resolution mechanisms.	• Alternative conflict resolution mechanisms, including justices of the peace.
• Updating of legislation and procedures	• Modernization of commercial, fiscal, financial and procedural legislation.	• Simplification of legislation to promote the access to rights of the poor and disadvantaged.
• Citizen security	• Citizen security programs to improve the investment climate.	• Citizen security to reduce the cost of violence for the poor.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
C. State, Market and Society	**Strengthening of the linkages between the state, market and society**	**State, market and equity**
Objective: Improved institutions and policies to promote competition and development, indispensable for economic growth and widening opportunities for the poor.	*Objective:* Market competitiveness and efficiency.	*Objective:* Widening markets and economic opportunities for the disadvantaged.
Sub-sections:	*Actions:*	*Actions:*
• Professionalism of the economic management institutions	• Institutions for macroeconomic and financial stability.	• Reduce the volatility of fiscal support to poverty reduction and support to market development.
• Institutions for market regulation	• Strengthen institutions responsible for regulation and for promoting competition.	• Limit negative externalities to vulnerable groups.
• Institutions for the design of active and inclusive policies	• Institutions and policies that promote economic development.	• Participation of excluded sectors in the formulation of public policies.
• Socioeconomic partnership institutions and instruments	• Development of social partnership institutions for a more balanced representation of economic interests.	• Social partnership policies and institutions that include and strengthen the interests of disadvantaged sectors.
• Environmental governance institutions	• Development of markets under the criteria of environmental	• Protection of minorities against factors of environmental vulnerability.

(continued on the next page)

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
D. Public Management	**Modernization of public management**	**Public management for equity**
Objective: Greater efficiency in public management in the design and and execution of public policies, necessary for growth and attending to the needs of excluded sectors.	*Objective:* Effectiveness and efficiency of services.	*Objective:* Targeting policies and resources to the poor.
Sub-sections:	*Actions:*	*Actions:*
• Civil service	• Professionalization of economic management institutions.	• Professionalization of state institutions responsible for poverty programs.
• Fiscal capacity, efficiency and transparency	• Expansion of fiscal capacity, improvement of transparency and expenditure management.	• Greater fiscal capacity of the state to fight poverty, and greater transparency and efficiency to improve social equity.
• Elaboration and coordination of policies	• Strengthening of the capacity to develop sustainable economic growth policies.	• Development of the capacity to fight poverty, including the targeting of programs.
• Public services management	• Modernization of public services delivery systems.	• Improvement in the management of public social expenditure and in the participation of community organizations in management.
• Greater use of information and communications technologies	• Application of new technologies to improve efficiency and transparency, for example, in public procurement.	• Improvement in the access of the poor to services through new technologies.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

SOCIAL DEVELOPMENT

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This document was prepared by María Loreto Biehl, José Brakarz, Elisa Fernández, Ernest Massiah, Jacqueline Mazza, Andre Medici, Andrew Morrison, Ada Piazze, Juliana Pungiluppi, Eduardo Rojas and Alfredo Solari of SOC; Anne Deruyttere (IND); Aimee Verdisco (EDU); Claudia Piras and Gabriela Vega (WID) and Mayra Buvinic (coordinator, SOC). The document is part of a package of strategies processed by Carlos M. Jarque (Manager, SDS) and benefited from comments obtained by an Inter-Departmental Working Group formed by Marcia Arieira (SO1), Sudhanshu Handa (SO3), Karen Mokate (INT) and Peter Sollis (SO2). Contributions were also received from Christian Gómez (SO2), Christof Kuechemann (Deputy Manager, SDS) and Juan Carlos Navarro (EDU). Suggestions and comments were received by Omar Arias (POV), Ernesto Castagnino (SGC), Suzanne Duryea (RES), Sarah Howden (CJA), Luis Fierro (SDS), Amanda Glassman (SO3) and Guilherme Sedlacek (OVE), among others. The document benefited from the results of an anonymous telephone survey to Bank clients in 26 countries, an anonymous survey to IDB social specialists at Headquarters and in Country Offices, numerous consultations with governments, civil society and donors, and background studies (available from SDS/SOC). The authors would like to thank all these contributions.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

OBJECTIVE



The IDB's Eighth Capital Replenishment and the Institutional Strategy have singled out social development as a key support of the Bank's commitment to promote growth, improve well being, and fight poverty and inequality in the region. The present strategy heeds these calls as well as the recent pledge countries have made to fulfill the Millennium Development Goals (MDGs). It fits into a package of seven mutually reinforcing strategies, of which two respond, respectively, to the overarching goals of sustainable economic growth and poverty reduction, and the others to four priority areas—modernization of the state, competitiveness, regional integration, and social development—in support of these goals. The package also includes environment, as a cross cutting area.

There is no consensus on the scope of the term "social development." For the purpose of this document, social development comprises investments in human and social capital for advancing people's well being. It includes actions in health and nutrition, education, housing and labor markets, which expand individual capabilities and opportunities, as well as actions in promoting social inclusion and combating social ills, which enrich the social fabric needed for human development.

The evidence shows that social progress speeds growth while social ills slow it down. In reciprocal fashion, sustainable economic growth also provides a conducive environment for social progress. Similarly, social progress can be expected to nurture democratic institutions and vice-versa.

The objective of the strategy is to help countries accelerate social progress, for its own sake, for poverty reduction and for growth promotion. It meets this objective by fostering human and social environments conducive to the well being of all, with special emphasis in the reduction of poverty and inequities in opportunities, especially inequities based on gender, ethnicity, race and disability, among others. It seeks advancements in the well being of all and greater proportional advancements in the well being of the poor and excluded.

The principles of *universality, solidarity, efficiency*, and *sustainability* inform and guide the strategy. *Universality* signifies that no one should be denied the opportunity to satisfy basic needs, within the constraints imposed by the productive dimensions of the economy. Targeting, by favoring those who are poor and excluded in the allocation of public resources, is an instrument for pursuing universal access. Similarly, "tailoring," which calls for modifying service delivery to respond to the user's social and cultural environment, is a tool for furthering universal access in ethnically and culturally diverse societies. Movement towards the goal of universality fosters greater participation and social cohesion.

The closely related principle of *solidarity* prescribes shared responsibility by the public and private sectors for financing social programs. One of its manifestations is an effective and equitable tax system. Solidarity builds on the notions of fairness and, in contrast to the notion of charity, on enlightened self-interest. Solidarity motivates redistributive measures, including the more equitable

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

distribution of government social expenditures, to correct inequalities that result from market failure. Solidarity also underlies the corporate social responsibility of firms. The allocation of public resources should heed the principles of *efficiency*, whereby the best possible results are achieved in terms of desirable outcomes of social policies (such as transparency of programs as well as coverage, quality and feasibility of social services) for given allocations of resources. Lastly, the *sustainability* of social action requires broad domestic support for and ownership of social policy. Citizen consultation in the design of social policy and broad dissemination of factual information on policy results fosters transparency, empowers citizens, and insures sustainability.

The strategy builds on the following issues: (a) that the obstacles to advancing social development in the region are deeply rooted in the interconnected problems of inequality and structural poverty; (b) that the reforms in health, education and housing need to address pending implementation issues; (c) that despite recent progress in social action, countries continue to experience the problem of responding with partial, sector specific solutions to complex social problems that have multiple causes, are interrelated and have intergenerational consequences; (d) that social exclusion and social ills hamper economic growth and social well-being and need concerted action informed by gender, ethnic and race concerns, among others; (e) that poor and excluded territories need more integrated efforts; and (f) that one of the main comparative advantages of the IDB, grounded in both its substantial social lending record and familiarity with the region, is assisting countries in meeting the challenges posed by social development. This assistance needs to be in close coordination with that of other donors. Being the largest source of multilateral lending in the region, the IDB is well placed to take a leading role in fostering this coordination.

In response to these principles and issues, the strategy proposes four lines of priority actions: (a) customizing social sector reforms; (b) advancing human development with a life-cycle perspective; (c) promoting social inclusion and preventing social ills; and (d) advocating the delivery of integrated services with a territorial focus to combat the multiple disadvantages of the poor and excluded. The strategy provides a framework and a menu of options for the Bank's work in social development. It must be underscored, however, that the region is very heterogeneous and that the selection of country-specific priorities within this framework should emerge from the dialogue with the country and be shaped by particular country circumstances. Country dimensions that should affect the definition of specific priorities include the level of economic development; the stage of demographic transition; the ethnic and racial composition of the population; and the size of both the rural population and the informal sector, among others. These dimensions should be highlighted in the specific Country Strategic Papers. The next section identifies social challenges by analyzing trends and patterns in social indicators and in the conduct of social policies.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



SOCIAL INDICATORS

Gauged by tracking the performance of social indicators, LAC's social progress is decidedly mixed. The message is one of notable gains in average scores and lingering problems reflected in the markedly unequal distribution of these scores among and within countries.

The region's good performance in average social indicators is well captured in the UNDP's widely used Human Development Index (HDI). The population-weighted aggregate HDI for the region, which combines life expectancy at birth; literacy of people over 15; school enrolments in primary, secondary and post-secondary; and GDP per capita (in constant 1987 PPP), rose from 0.66 in 1975 (for 21 countries) to 0.76 in 1999 (for 26 countries). Only the set of developed countries show a higher average HDI score than LAC, and the gap in rates between them has narrowed over time. The region's pace of progress, after adjusting for its level of economic development, has been slightly better than worldwide averages for basic indicators of health (life expectancy and infant mortality), literacy and primary enrolment. However, compared to world patterns, LAC has underperformed in reducing maternal mortality rates and in raising secondary school enrolments and the number of years of schooling of the adult population.

A complementary yardstick to track LAC's social gains is its progress towards the Millennium Development Goals (MDGs). The MDGs directly related to gains in social development are: i) achieving universal primary education; ii) promoting gender equality and empowering women; iii) reducing child mortality; iv) improving maternal health; v) combating HIV/AIDS, malaria and other diseases; and vi) ensuring environmental sustainability by improving access to safe drinking water and the lives of slum dwellers.

The gains to date with respect to these MDGs are summarized in Box 1. The region as a whole has performed comparatively well in achieving universal primary education, gender equality in schooling, reducing child mortality, access to safe drinking water, and control of HIV/AIDS and other infectious diseases. Especially notable is the progress concerning gender equality in school enrolments, where the goal set for 2015 has already been met and exceeded. Good overall performance, however, masks large between and within country differences and it does not ensure that most goals will be met by the target dates. In particular, there are large numbers of urban slum dwellers and rural populations in several countries without access to safe drinking water. There is high prevalence of HIV/AIDS in specific subregions (Caribbean and Central America) and deep concern regarding the generalization of the epidemic. The containment of malaria, TB and dengue is an ongoing challenge as well.

These and other important challenges (detailed in Box 1) bearing on the MDGs clearly remain. Among them, the goal of reducing maternal mortality rates, where the region has made little progress in the past decade, and the continuing disadvantages women face in the labor market, which stand in stark contrast to their schooling gains. These disadvantages are especially severe for poor women of indigenous or African descent and women with disabilities.

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

Box 1: LAC's Achievements and Challenges in Attaining Selected MDGs

Goal	Achievements	Challenges
• Ensure that, by 2015, children will will complete primary schooling, and eliminate gender disparity in primary and secondary education.	Primary completion rates rose to average of 82%, with a 4% average gain per country since 1990. Repetition declined from 29 to 16% (14 countries).[1]	Eighteen percent of the Region's youth do not complete primary education education and 16% repeat. (14 countries)[2] Less than 50% of secondary enrolled enrolled students complete the cycle. Only 10% do so in rural areas.[3]
• Promote gender equality and empower women	Close to 60% of women are enrolled enrolled at the secondary level and 19% at the tertiary level; for men, these figures are 54% and 17%, respectively.[4]	
	Share of women in the non-agricultural sector rose from 38% to 41.2% (1990–99).[5]	Labor market segregation rates by gender is highest (0.44 in the Duncan Index) in the world in early nineties[6]
	The gender wage gap narrowed from 25% to 17% average in last decade (17 countries)[7]	In the 90s, women's unemployment and underemployment rates were 3% and 8% higher than those of men, respectively (12–19 countries).[8]
	Share of women in Senate increased from 5 to 17%; in lower chamber, from 9 to 13% (26 countries)[9]	Eighty-three percent of senators and 87% of lower chamber representatives are men (26 countries).[10]
• Reduce by two thirds, between 1990 and 2015, the under-five mortality rate.	Infant and child mortality was reduced by 30% and 26%, respectively (1990/2000).[11]	In year 2000 infant mortality was 29 per 1000, and child mortality rose to 36.7 per 1000.[12]
• Reduce maternal mortality (3/4 between 1990–2015)	Coverage of hospital deliveries improved from 70.8% of all births in 1990/95 to 86.5% in 1997/2000.[13]	The regional average maternal mortality rate for 1995 was still 190 (per 100,000 live births), compared to 140 for East Asia and the Pacific and 36 for Europe and Central Asia.[14] The regional adolescent fertility rate in in 1999 was 73 (births per 1,000 women ages 15–19), well above the levels of Middle East and and North Africa, East Asia and the Pacific, and Europe and and Central Asia.[15]

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Box 1: LAC's Achievements and Challenges in Attaining Selected MDGs

Goal	Achievements	Challenges
• Detain and reverse the spread of HIV/AIDS, malaria and other diseases	The overall regional incidence of HIV/AIDS is less than 1% of the adult population aged 15–49.[16]	There are 1.9 million people in LAC and the Caribbean living with HIV/AIDS. Prevalence is 2% in the Caribbean — the second fastest fastest growing in the world. (7 countries studied)[17]
		Prevalence of HIV/AIDS of over 5% has been recorded in high-risk populations (i.e. intravenous drug users, commercial sex workers and men who have sex with men).[18]
		Women are now an important risk group, with 23% of all cases.[19]
	Incidence of malaria appears to have stabilized. The lowest number of cases since 1997 was reported in 2000 (1.14 million).[20]	In 1999 there were more than 1.2 million cases of malaria; the Region also recorded more than 3 thousand cases of P Falciparum (15 countries)[21]
		TB cases went from 195.7 to 220.5 thousand in the last decade.[22]
		The number of cases of dengue in in the Americas has gone from 66,011 in 1980 to 700,000 in 2002.[23]
• Increase access to safe drinking drinking water (halve the proportion of people without access)	Safe drinking water coverage increased almost 10% in the last decade, with a current average coverage of 84.6%, and an urban coverage above worldwide average. (16 countries)[24]	The overall safe drinking water coverage rate for the Region's rural areas remains below below 65% coverage.[25]
• Increase access to improve sanitation and secure tenure (improve the lives of slum dwellers by 2020)	The average of sanitation coverage in the Region during the last decade was 75.7%. (16 countries)[26]	Conservative estimates indicate that by year 2000 more than 17 million households shared shelter with others and 21 million lived lived in inadequate housing.[27]
	Large countries have reached more more than 90% sanitation coverage of total population in the last decade, while small countries have reached close to 85%.[28]	One-third of the households in higher income countries have inadequate conditions, while more than half of the households of low-income countries do so.[29]

References: (on next page)

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Box 1: LAC's Achievements and Challenges in Attaining Selected MDGs (continued)

References:

1 Wolff, L., E. Schiefelbein, and P. Schiefelbein. 2002. Primary Education in Latin America. Technical Papers Series EDU-113, Education Unit, Sustainable Development Department, Inter-American Development Bank, Washington, D.C.
2 *Idem.*
3 *Idem.*
4 Sustainable Development Department. 2000. Reforming Primary and Secondary Education in Latin America and the Caribbean: An IDB Strategy. Sector Strategy and Policy Papers Series EDU-113, Education Unit, Sustainable Development Department, Inter-American Development Bank, Washington, D.C.
5 The World Bank. 2002. World Development Indicators 2002. Website of the World Bank. http://www.worldbank.org/data/wdi2002/index.htm.
6 Blau, F. and M. Ferber. 1992. *The Economics of Women, Men and Work*. Englewood Cliffs, New Jersey: Prentice-Hall.
7 Duryea, S.; Cox, A., and M. Ureta. 2001. Women in the LAC Labor Market: The Remarkable 1990s. Working Paper, Women in Development Unit, SDS/SOC, Inter-American Development Bank, Washington, D.C.
8 International Labor Organization. 2001. *Panorama Laboral 2001: América Latina y el Caribe*. Lima: International Labor Organization.
9 Inter-American Dialogue and International Center for Research on Women. 2001. Women and Power in the Americas: A Report Card. Website of the Inter-American Dialogue. http://www.iadialog.org/publications/womenandpower_emb.pdf.
10 *Idem.*
11 Barros, F. 2002. Maternal and Infant Health in Latin America and the Caribbean. Presentation at seminar, Latin America and the Caribbean: Challenges before the Millennium Development Goals. 10–11 June, Washington, DC.
12 *Idem.*
13 The World Bank. 2001. World Development Indicators 2001. CD ROM. Washington, D.C.: The World Bank.
14 Hill et al., "Estimates for Maternal Mortality for 1995", Bulletin of World Health Organization, 2001, 79(3).
15 The World Bank. 2001. Idem.
16 Joint United Nations Programme on HIV/AIDS. 2002. *Report on the Global HIV/AIDS Epidemic: The Barcelona Report*. Geneva: Joint United Nations Programme on HIV/AIDS.
17 Pan American Health Organization/World Health Organization. 2002. Acquired Immunodeficiency Syndrome (AIDS) in the Americas. Document CSP26/7. 26th Pan American Sanitary Conference, 54th Session of the Regional Committee. 23–27 September, Washington, D.C.
18 Joint United Nations Programme on HIV/AIDS. 2002. Idem.
19 *Idem.*
20 Pan American Health Organization/World Health Organization. 2002. Status Report of Malaria Programs in the Americas. Document CSP26/INF/3. 26th Pan American Sanitary Conference, 54th Session of the Regional Committee. 23–27 September, Washington, D.C.
21 *Idem.*
22 World Health Organization. 2001. *Global Tuberculosis Control: WHO Report 2001*. Geneva: World Health Organization.
23 Pan American Health Organization. 2002. *Health in the Americas*. Volume No. 1. Washington, D.C.: Pan American Health Organization.
24 The World Bank. 2000. World Development Indicators 2000. CD ROM. Washington, D.C.: The World Bank.
25 Centro Panamericano de Ingeniería Sanitaria y Ciencias del Ambiente. 2001. Statistical Data. Website of the Centro Panamericano de Ingeniería Sanitaria y Ciencias del Ambiente (OPS/OMS). http://www.cepis.ops-oms.org/.
26 The World Bank. 2000. World Development Indicators 2000. CD ROM. Washington, D.C.: The World Bank.
27 Rojas, E. et al. 2002. Sharpening the Bank's Capacity to Support the Housing Sector in Latin America and the Caribbean. Technical Paper (Draft), Social Development Division, Sustainable Development Department, Inter-American Development Bank, Washington, D.C.
28 Centro Panamericano de Ingeniería Sanitaria y Ciencias del Ambiente . 2001. Idem.
29 Rojas, E. et al. 2002. Idem.

Given LAC's high levels of development and urbanization compared to other underdeveloped regions, countries may wish to adjust the MDGs accordingly. In particular, this strategy incorporates the goal of secondary school coverage for at least 75 percent of young people by the year 2010, agreed in the Quebec (2001) Summit of the Americas. The region's low performance in secondary schooling is a major stumbling block for increasing its competitiveness in the world economy. Less than 50 percent of the cohort of children who start secondary schooling, complete the cycle leading to low schooling levels of the labor force. In rural areas, rates are dismally low, rarely exceeding 10 percent.

Inadequate housing can also reduce human and social capital formation and has a negative impact on growth. Conservative estimates indicate that in the year 2000 more than half of all households in low-income

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

countries and a third in high income ones, totaling more than 21 million households, lived in inadequate housing.

The region's historically high levels of inequality are closely related, both as cause and effect, with "structural" poverty that is passed from parents to their children across generations. Social exclusion is often another feature of structural poverty and, along with its intergenerational dimension, helps to explain the skewed distribution evident in the social indicators data—the significant progress for some, the lack of progress for others. The region's overall poor economic performance in recent years and the often severe recurrent economic shocks, together with the occurrence of natural disasters, have also contributed mightily towards entrenching poverty and exclusion, thereby further limiting the aspects of social progress captured by the indicators.

Children (0 to 17) bear the brunt of poverty. Almost 44 percent of all children (compared to 27.7 for adults and 28.6 for the elderly) live in poor households, using a US$2 per person per day poverty line, on a 1985 PPP basis, for a sample of 18 countries. The higher fertility of low income families, combined with the low educational level and meager income earning opportunities of parents, especially mothers, are chief determinants of child poverty and provide critical links in its transmission across generations. Particularly concerning is the situation of unpartnered mothers and their children, which constitute a growing proportion of poor families in the region.

Disadvantages cumulate over the life cycle, hampering children's human capital formation today, which in turn diminishes their productivity and subsequent income as adults. Despite improvements, by the year 2000 between 20 and 60 percent of children in the lowest income quintile in different LAC countries suffered from malnutrition. In the region, disadvantages accumulate quickly. Thus, by age 18 almost half of the 0 to 18 cohort has experienced some basic developmental "failure," reducing these children's odds of ever joining a globally competitive work force and escaping poverty.[1]

Social exclusion is a heavy drag on several aspects of social development. Socially excluded populations by reasons of gender, age, race and ethnicity, disability and other features attributed to people constitute a sizeable (although still not reliably counted) segment of the population in the region.

While these populations have their unique histories and group identities, they have certain common features: they constitute a large proportion of the poor, suffer multiple and cumulative disadvantages, stigma and discrimination, and rank consistently lower in indicators measuring progress towards the MDGs. For instance, in Brazil, Bolivia, Guatemala and Peru, the incidence of poverty is twice as high for indigenous and Afro-descendent groups than for the rest of the population. Child mortality among indigenous groups in Guatemala is 79 for 1,000 live births, compared to 56 for the rest of the population. Maternal mortality rates are higher among indigenous than nonindigenous women, and indigenous women in Guatemala get substantially less schooling than nonindigenous women (and indigenous men) and also earn significantly lower incomes for the same level of schooling.

The inability of the poor to break out of the poverty trap has also been adversely affected by persistently weak labor markets in the region, characterized by high levels of underemployment, informality and unemployment. Weak labor markets, especially for underskilled workers, choke potential oppor-

[1] Developmental "failure" was defined as the accumulated shares of those dying before the age of five; those 8 to 11, 12 to 14 and 15 to 16 year olds not enrolled in school; and those youth ages 17 to 18 unemployed and not in school (data for 12 countries).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

tunities for inclusion and mobility. A further characteristic of weak labor markets is the weak observance of core labor standards promulgated by the ILO: the prohibition against forced labor, child labor and discrimination, and the right to free association and collective bargaining.

The percentage of workers without access to health and unemployment coverage through social security, healthy and safe work environments and pension systems is very high and continues to rise. In some countries as high as 85 percent of all workers may lack social security coverage. The growth of informal sector employment and rising survival rates of older people, especially women with a history of work in domestic nonmarket production, have contributed to lower social security and pension coverage ratios.

The HDI and the MDG indicators are useful gauges of social progress but naturally fail to capture some important social problems. Very notably, they do not reflect the rising crime and violence in the region, which, among other distressing consequences, obstruct social and economic progress, affect the poor most severely, and exacerbate the region's high-income inequality. Regionwide, homicide rates, the second highest in the world, doubled from the mid-eighties to the mid-nineties, and continue to soar. Where data are available, the incidence of domestic or intrafamily violence is also very high. In some countries up to a quarter of all adult women and more than a third of all children suffer physical violence in the home. Unsurprisingly, crime and violence are consistently mentioned as prime sources of concern in opinion polls.

Social progress depends importantly on the institutional capacity of countries and the performance of governmental and nongovernmental actors in the social sectors. Recent overall trends in social sector indicators that are more closely associated with social policies and programs are discussed next.

SOCIAL POLICIES AND PROGRAMS

The nineties witnessed renewed international and national attention to social development. The UN convened a series of global conferences on social issues, including topics on women, population, social development, racism, housing and human settlements and, more recently, the UN oversaw the international agreements on the MDGs and sustainable development. Other international agencies as well as multilateral and bilateral donors followed suit and devoted increasing resources to social issues. Within the region, national commitment was best reflected in a sharp rise in government social expenditures.

Governments assigned higher budget shares to social expenditures, which also rose as a proportion of GDP. Social expenditures include expenditures in health, education, social security and welfare, housing and community services (mainly, water and sewage). In a sample of 23 countries in an IMF data set, social expenditures by the central government climbed from 7.7 percent of GDP in 1970 to 12.3 percent in 1999, as Figure 1 reveals. An ECLAC data set comprising 17 countries, but one that includes central as well as sub-national government outlays, shows that social expenditures rose from 10.4 percent of GDP in 1990 to 13.1 percent in 1999. Per capita social spending rose by 50 percent in the IMF data set and by 56 percent in the ECLAC data set in this ten-year period. Most of the increase in social expenditures over the nineties was due to the fiscal priority given to these expenditures rather than to the growth in public resources.[2]

Along with greater commitment and rising budgets, there was growing decentralization of government functions and im-

[2] Economic Commission for Latin America and the Caribbean. 2001 "El gasto social en América Latina: Balance de una década." In *Panorama Social de América Latina 2000-2001*.ECLAC: Santiago.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

provements in the delivery of social services. Thus, schools are better today than a decade ago. More children attend school, begin earlier, stay longer, complete higher levels and represent all socioeconomic and ethnic backgrounds. Health reforms during the nineties, despite many problems, reduced pressures for increased public expenditures and enhanced the efficiency of public health systems. New and recast housing programs were put in place by governments that adopted enabling policies and mobilized private sector resources.

There was progress in the conceptualization and design of social assistance and social protection programs as tools for investing in human capital and managing risks. In particular, demand-side interventions such as Bolsa-Escola (Brazil) and PROGRESA (Mexico) were shown to play a crucial role in promoting the human capital accumulation of the poor. Targeting mechanisms were refined, and more attention was given to monitoring and impact evaluations. A visible achievement was the increased involvement of civil society actors in framing social policy and social programs. This participation has moved well beyond the contribution of voluntary labor of earlier decades. Governments can take credit for devising new mechanisms for seeking wider societal consensus in the design of social policies.

Notwithstanding these gains in social programs, the reforms in health, education and housing have not overcome implementation problems nor succeeded in expanding needed access to quality basic health, education and housing services to the poor, thereby leaving many effectively excluded. Citizens' participation in the processes of social sector reform and, more generally, in the formulation and implementation of social policy, remained inadequate to insure ownership of social objectives and continuity of social reform. In addition, donors' increased interest in social development has not translated into greater coordination and synergies.

The social expenditure growth varied markedly among countries. Needing to provide pension benefits to a larger and older formal sector labor force, spending on social security grew faster in the richer countries, while spending on health and education grew more in the poorer ones. The former spending, however, did not significantly increase social security coverage. In addition, in some cases spending went to support pensions for special professional categories that provide actuarial benefits larger than paid contributions financed by general taxpayers. Several Asian countries show better results in health and education despite lower per capita expenditures, suggesting that there is much room for improvement in the efficiency of the region's social expenditures, implying considerable potential for expanding coverage of the poor at current levels of resources.

There is great diversity in patterns of expenditure across countries and over time. Yet, throughout the region, social sector public spending needs to increase the share of resources directed to the poor and improve its targeting. This, together with a pro-cyclical trend in social expenditures suggests that there is ample room for improving redistribution and poverty reduction outcomes for the resources being spent. The latter is particularly important since the economic stress in large parts of the region since the turn of the century is causing a severe retrenchment in aggregate fiscal expenditures.

While social development calls for early and coordinated intervention, social policies and programs have focused insufficiently in prevention of social ills and in key transitions in the life cycle of individuals and families. Also, strategies capitalizing on powerful synergies that can be tapped by cross social sector interventions remain the exception. And programs fall short in combating exclusion. Yet, there are enough examples of successes in all these areas—in institutional reforms, building early on the life cycle, combating exclusion, preventing social ills, and provid-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ing integrated services—that they provide firm grounding for the recommendations in this document. The lessons learned from Bank and country experiences in each of these areas inform the priorities in this strategy. They are briefly summarized next.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



REGIONAL EXPERIENCE

The Implementation of Social Sector Reforms

As noted earlier, lack of access to basic social services of quality by the poor, especially in the areas of health, education and housing, is at the core of inequality and poverty. Effective reforms of these services are means to create an institutional environment to achieve social development goals and should, therefore, be a priority in government social policy. It is essential that the formulation, execution and evaluation of public policies take place in an institutionally solid and democratic governance environment. Two decades of experience in the region show that such reforms share distinctive implementation difficulties, particularly: i) *difficulty in monitoring performance*, since reform outputs are hard to trace and measure; ii) *political factors* skewing benefits towards those who are ahead, powerful and influential, thereby *undermining the equity goal* of social sector programs; iii) *strongly centralized systems* that exacerbate the problems of serving poor clients with limited ability to demand fair treatment by service providers and provide feedback; and iv) the mismatch between politically defined financial resources and social objectives, such as the provision of universal services, *and the reality of severe constraints on implementation capacity*.[3] Beyond sector specific lessons for health, education and housing reforms, summarized in Box 2, recent experience offers additional lessons, which can be translated into criteria for more effective implementation.

Reform does not happen overnight. To take hold, reforms require long gestation and continuity in policy focus. Reforms are long-term processes that extend beyond political and project cycles. Since they rarely offer immediately visible social benefit, while entailing high up-front economic and political costs, the reform process often derails before reaching its objective.

There are winners but also there are losers. Not all changes brought about through reforms in the social sectors are win-win and the policy package seldom rewards all players. Reforms involve and affect diverse stakeholders with diverging perspectives and interests. Finding the right political formula and managing it deftly is as important as ensuring technical and financial viability.

Reforms are difficult to explain and sell. The complexities of consequential social reforms, including elements of up-front costs and delayed results, long gestation periods, and winners and losers, make them difficult to sell to the public. Phasing reforms into discrete, more achievable and understandable objectives and tasks, and using effective communications and social marketing, are often indispensable for success.

Good management practices matter. Effective reform requires effective, adaptive and strategic management, features which have been

[3] See "Supporting Reform in the Delivery of Social Services: A Strategy," IDB 1997.

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

Box 2: Social Sector Reforms: Lessons Learned

Health.[1] The health system is complex and politically very sensitive; reforming takes time, and requires both adaptation to local conditions and effective political dialogue. Experience with reform has shown that:

- Institutional analysis and adequate incentives are needed to address conflicts between alternative options and divergent interests of different agents.
- Implementation should be in stages with measurable results.
- The reform process should foster transparency, trust, political will and realistic expectations.
- Large-scale training of human resources is needed for success.

Education.[2] While the effectiveness of the decade-plus systemic reforms remains an issue of debate, the activism that has taken place in the education systems has produced useful lessons:

- More access can lead to better education.
- Increasing access is not sufficient, however. Access without quality can stunt competitiveness.
- Equity enhancing programs targeted towards the poor are needed to level the playing field of educational opportunity.
- Targeting supply- and demand-side interventions are needed.
- With the right policies in place, no significant trade-off may exist between quality and equity in the current conditions of educational development in the region.
- In order for technology to improve educational access, equity and quality, it needs to be structured with a clear understanding of educational goals and objectives.

Housing.[3] Government programs that build finished housing have been unable to meet the needs of the majority of low-income people. Similarly, government-sponsored finance mechanisms providing subsidized loans are unsustainable. In response, several governments adopted enabling policies to mobilize resources of communities and the private sector for housing production and finance. Lessons from this experience include:

- The enabling approach to housing reform leads to better results after several years of sustained efforts, underscoring need for long term perspective and political commitment.
- A two pronged strategy for improving both the flow and the stock of houses is required.
- Innovative low-cost solutions are needed to expand housing for low-income families.
- It is important to pay more attention to factor markets and promote entrepreneurship.

References:

[1] Medici, A. 2000. Las Reformas de salud en América Latina y el Caribe. En *La hora de los usuarios: reflexiones sobre economía política de las reformas de salud*, eds. H. Sánchez and G. Zuleta. Washington, DC: Inter-American Development Bank and Centro de Estudios Salud y Futuro.
Izaguirre, M. 2002. Entrevistas en profundidad con clientes de programas sociales en Bolivia. Background paper for the Social Development Strategy, Inter-American Development Bank, Washington, D.C.
Medici, A., and L. Biehl. 2002. *Encuesta de opinión de Especialistas Sociales del Banco Interamericano de Desarrollo*. Working Paper, Social Development Division, Sustainable Development Department, Washington, D.C.

[2] Sustainable Development Department. 2000. *Reforming Primary and Secondary Education in Latin America and the Caribbean: An IDB Strategy*. Sector Strategy and Policy Papers Series, Education Unit, Sustainable Development Department, Inter-American Development Bank, Washington, D.C.

[3] Angel, S. 2002. The IDB Housing Sector Strategy: Diagnosis and Evaluation. Background paper for the Social Development Strategy, Inter-American Development Bank, Washington, D.C.

largely absent in social sector organizations. There is need to develop and motivate a group of leaders willing to affect organizational change and lead the management teams which will carry out sustainable reforms.

Results can be easily undone. As in other spheres of development, economic and fiscal crises as well as changes in governments often reverse progress of established reforms. Macroeconomic stability is an important factor for success, and broad support among

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

social and politically vocal groups increase the chances of reforms surviving over different government administrations.

Consultations and social dialogues nurture reform efforts. Citizen participation ("voice") and ownership increase the viability of social reforms. Constructive consultations and social policy dialogues, however, require time, specific objectives, clear rules, resources and open and inclusive processes. One-shot dialogues do not work.

Customized responses work best. There is no one-size-fits-all model for reforming the social sectors. Whereas the goal of any reform may be expressed in very general terms, the design and implementation of specific reforms need to be carefully tailored to meet the characteristics of the clients and the peculiarities of local circumstances—political, social, institutional, cultural and economic.

Bringing in the private sector can help. Evidence is mounting that there is an important role for the private nonprofit and for-profit sector in providing and financing social services. Where this has happened, the role of government has changed from one of full responsibility to one in which it is shared with private parties. The "enabling approach" to social policy, whereby governments establish clear rules under which both the public and private sectors operate to design and deliver services, has been particularly successful.

Programs that Build Human Capital Early

The inter-generational transmission of poverty (ITP), the process by which disadvantage is passed between generations, is a root cause of structural poverty in the region. By diminishing opportunities for the children of the poor to build their human capital, ITP hobbles their future productivity, as well as countries' productivity and growth prospects. But ITP can be halted, and early intervention pays off.

- *Families matter for poverty reduction.* Family related factors influence early human capital formation, lifetime prospects, and deserve greater attention in driving demand for poverty reduction policies and programs.

- *The life cycle is an underutilized policy tool.* Predictable stages and transitions in the life cycle of families and individuals offer opportunities to build policies that seek to break the ITP by providing comprehensive support to poor families and supplementing parental investment in their children.

- *Start early for success and savings.* Prenatal care and childhood nutrition and health, as well as early stimulation and social learning, are critical from social development and educational perspectives. Investments in early childhood care and development and preschool can lower the cost of primary schooling, especially for low-income children who normally come unprepared, and oftentimes additionally impaired, by physical and mental development to learn in first grade. By raising readiness to learn, learning expectations in schools also rise, producing significant improvements in overall teaching, student performance, and student flows in later cycles. Targeted early childhood development also reduces inequity, improves health, and, by improving educational outcomes, it can be expected to have a long-term impact on increased employability and reduced delinquency.

- *Children thrive with empowered mothers.* Ample evidence supports the finding that increasing poor women's access to and

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

control over resources pays off in terms of greater child well being. Innovative demand-side programs aimed at combating ITP already exist in LAC (for instance, in Brazil, Honduras, Mexico and Nicaragua) and positively build on women's empowerment and mothers' preference for investing in children by, among others, having women as the recipient of conditional transfers to participating households that comply with school attendance and other program requirements.

- *Food security is not enough.* In addition, appropriate feeding practices are fundamentally important to the survival, growth, development, health and nutrition of infants and children. Nutrition education, food supplemen-tation and fortification with essential micronutrients are as important as food security in fostering the healthy development of children.

Recent Experiences in Fighting Exclusion and Combating Violence

Inclusion policies, which channel public investments to remove barriers to access by certain groups to quality services and productive resources, are of recent vintage and systematic information on what works, how it works, and how much it costs is largely absent. Tentative lessons, nevertheless, can be gleaned from some budding cases.

- *If it is not identified and counted, it does not exist.* The numerical invisibility of excluded groups in official statistics reflects and reinforces their exclusion. It impedes designing appropriate targeting mechanisms, monitoring project implementation, and assessing project impacts.

- *Tailoring services is viable.* Increasing access of excluded groups to basic services by modifying design features, such as adapting infrastructure to meet the needs of the disabled or including indigenous preferences in health service infrastructure and delivery, is feasible and not necessarily unaffordable (in the U.S., where data exists, universal design for the disabled adds less than 1 percent of total costs in new infrastructure projects).

- *Preferential policies can work.* The actions of a number of LAC governments, some of which are described in Box 3, suggest that well-designed specific interventions, including using labor market intermediation tools and preferential treatment through incentives and quotas, can help expand access and opportunities, sparking little or no adverse public reaction.

- *Good policies and mandates are not enough.* Anti-discrimination and other affirmative legislation, as well as policy mandates, are necessary but not sufficient in themselves to combat exclusion. Societal attitudes and differences in power underlie and perpetuate exclusion.

- *Inclusion and assimilation are not the same.* As past work with indigenous peoples show, projects fail when they do not recognize the cultural characteristics and values of excluded groups. Inclusion needs to respect diversity and build on cultural identity. Diversity is an asset that enriches the social fabric and, if properly managed, projects outcomes as well.

Increased levels of crime and violence are exacting a large toll in terms of foregone economic growth and social development. Lessons learned from experience with crime and violence control programs in the Americas include:

- *Crime and violence can be reduced.* There are well-documented examples of cities in

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Box 3: Features of Successful Policy Dialogues[1]

Social policy dialogues seek to insure, through broad-based consensus, citizen ownership and sustainability of social policies. While there is no "one-size-fits-all" model, and dialogues have to be tailored to specific social and political circumstances, recent experience shows that constructive dialogues have the following common features:

- Are conceived as long-term processes. One-shot dialogues do not work.
- Have clearly defined, attainable objectives.
- Receive financial resources to insure inclusive and equal participation.
- Insure all actors have equal voice in the process.
- Processes are inclusive, insuring coverage both of excluded regions and groups.
- Climate of trust is fostered by clear and consistent rules on procedures and conflict-resolution modalities, which cannot be unilaterally changed mid-course.
- Rules sanction participants' ability to differ.
- Transparency is fostered by reliable, full information, available to all participants equally.
- Themes discussed are carefully sequenced, from the easier to more controversial ones.
- The government does not own the process, but is fully committed to it, and assigns financial, technical and human resources.
- Participants include representatives from the legislative branch of government and political parties as well as the executive branch.
- International agencies serve as facilitators and coordinate their support to the process among them.
- Agreed social policies have specific measurable objectives, assigned resources, implementation schedules, and follow-up mechanisms.
- Along with the dialogue, there is institutional strengthening of appropriate social sector agencies.

[1] Inter-American Development Bank. 2002. Seminar proceedings, The Role of Dialogue on Social Reform: Implications for IDB Social Development Strategy, 30-31 May, Santiago, Chile.

the region (e.g. Bogota and Cali), which have significantly reduced homicide rates by designing interventions based on epidemiological risk assessments and by seeking active partnerships between government and citizens.

- *Impunity matters.* The probability of capture and conviction are important determinants of economically motivated crime. Thus, actions to professionalize the police and judiciary can have significant impacts on crime rates. At the same time, naïve "get tough on crime" responses do not work: simply putting more police on the streets and lengthening prison sentences has been shown to be a particularly ineffective and expensive response which utilizes resources that could more efficiently be employed elsewhere.

- *Prevention is more cost-effective than control.* Despite evidence demonstrating its relative cost-effectiveness, crime prevention tends to be underutilized, in part because prevention initiatives that change individual behaviors and attitudes frequently produce results only in the medium term. There are, however, prevention measures that produce quick results by producing environmental changes to make violent or criminal behavior more difficult, more risky, and/or less rewarding. These situational prevention measures can complement more long-term social prevention strategies.

- *Violence begins at home.* Intra-family violence, particularly against women and children, generates other types of violence as children imitate the behavior of parents and learn at an early age that violence is an appropriate way to "solve" conflicts. Children who are victims of violence in the home or are mere witnesses are much more likely to become juvenile delinquents, for example, than those who are not.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

- *Programs should focus on a limited number of risk factors in order to remain manageable.* While the risk factors for crime and violence are numerous, programs that attempt to address too wide a range of risk factors become unwieldy; programs should focus on a limited number of risk factors for the types of violence, which are of highest priority.

Programs that Integrate Services

The resurgent interest in integrated programs is largely driven by demand from local governments and communities for new ways of dealing with the multidimensional problems of poverty and social exclusion. Interventions can be integrated by projects either providing an integrated package of investments and services in a defined territory or by sector programs, which are designed and implemented in close temporal and territorial coordination. Lessons learned from a new generation of integrated interventions in areas such as early childhood development, violence reduction, social protection, neighborhood upgrading, integrated watershed management projects and community development projects for ethnic and racial groups include:

- *Targeting territories works.* Defining the area of operation of social programs to specific territories facilitates coordination and enhances targeting since increasingly hard-core poverty and exclusion are concentrated in territorial areas. Universal service provision, which avoids potential selection errors and political costs of individual targeting mechanisms, is often feasible in demarcated territories. Moreover, there are potent synergies to be reaped when certain antipoverty interventions converge on a disadvan-taged household, which is easier to do when targeting territorially.
- *But beware of segregation.* Though much less so than income-targeted anti-poverty programs, even those that are targeted to all households in a territory are susceptible to segregation and even stigmatization of beneficiaries. They need to be compensated by sector interventions that reduce segregation.
- *Professional providers and empowered clients.* Transparent and efficient governance, a management by results orientation, and participation and empowerment of the beneficiaries increase the success of integrated interventions. Participation of implementers early on (in project design), a common sense of purpose, flexibility and simplicity maximize successful interagency coordination required in integrated interventions.

Recent Changes in Social Development Financing

Among donors there has been growing debate on increasing access to grant funds as opposed to loans, for addressing pressing social development issues. Global grant making mechanisms for the environment, HIV/AIDS, and education have or are being developed. The availability of these grant funds could reduce the demand for loans. The Bank needs to ensure that the range of services it offers is relevant in this changed environment for development financing.

The strategic priorities defined in this document build on these lessons as well as on lessons from the Bank experience with its social sector portfolio, including staff insights from managing this portfolio and clients' views on the Bank's performance. They are described in the section that follows.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

RECENT BANK ACTION

Lending Trends and Issues

Between 1994 and 2001, social lending which includes "traditional sectors" (health, education, sanitation, housing and urban development, and social investment loans) and "emerging social sectors" accounted for 39 percent of total volume and 37 percent of total number of IDB loans. It is important to note that when other loans for equity and poverty reduction are added to social sector operations focused on equity and poverty, the Bank performed above the 8th Replenishment goal of channeling 40 percent of the total volume of lending to operations addressing social needs, equity and poverty reduction (SEQ) between 1994 and 2001. However, in terms of number of operations over the same interval, SEQ loans made up 46 percent of aggregate approvals, still short of the 50 percent cumulative target. Changes in the composition of the social lending portfolio featured reductions in lending for investment projects and social investment funds while the shares of sector and emergency loans expanded.

Operations in the traditional social sectors have grown and diversified, notably including support of sector-wide reforms in health, education and housing. Lending in emerging social sectors supported projects in social protection, early childhood care and development, youth, neighborhood and slum upgrading, and the promotion of peaceful societies, among others.[4] The Bank's classification system for social sector operations is largely outdated, and needs revision, especially for capturing patterns in these emerging areas of Bank lending.

In a larger number of countries, Social Investment Funds (SIFs) are responsible for a significant proportion of the Bank's portfolio in the sector. On one hand, they have proven to be effective implementation mechanisms, with expedited procurement practices, fast disbursement cycles and concrete and measurable results. However, they need to be better integrated with the remaining governmental social institutions, in order to avoid duplicating efforts with the traditional social services. At the community level, the drawbacks in the SIFs are the lack of participation of local governments in the decision-making process and missed opportunities for strengthening their technical capacity by involving them more in the implementation process.

During the period, more than one thousand grants (non reimbursable technical cooperation – TCs) totaling over $400 million were approved for the social sectors, representing 57 percent of all nonreimbursable TC funds. Half of these grant funds went to social development activities, including operations bearing on children, youth, women and other priorities of the 8th Replenishment, attesting to the importance of grants for social development and project preparation in the social sectors. The use of grants instead of loans for these 8th Replenishment priorities responds to several factors, including characteristics of the loan portfolio of individual countries and the perception that some of these issues are not "bankable," at least in the short term.

There has been considerable progress in mainstreaming issues of gender, ethnicity and race in operations, although the precise extent of this progress is uncertain owing to the dearth of reliable indicators of the result of mainstreaming efforts. This is especially the case for gender issues. Roughly, about 28 percent of all Bank projects mainstream gender issues and 10 percent attend indigenous concerns. The percentages are much higher for social sector and poverty targeted projects. Among the latter, those featuring geographical targeting have been often used to incorpo-

[4] See Charles McDonald's "Social Strategy Input Paper" that addressed the Bank Lending History 1994-2001 in Social Sectors. Unpublished paper. IDB: Washington, D.C. 2002

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

rate interventions favoring indigenous peoples. More recently, the concerns of Afro-descendants have been addressed through an internal Bank action plan. As a result, there are a growing (but still low) number of projects focusing on this population. Only a handful of operations include measures to increase access of persons with disabilities to social infrastructure and services. From designing and managing this social sector portfolio, the following additional lessons emerge:

Institutions must be better understood. Well-designed and financed social sector projects fail to be implemented as planned when insufficient attention is given to institutional factors. Indeed, available evidence (e.g., the Project Performance Monitoring Reports) finds that delays and problems during implementation usually relate to weaknesses in the institutional capacities of executing agencies. In addition, project related training that professes to strengthen these capacities is in many cases inadequate and poorly evaluated. Institutional analyses deserve more attention in project preparation, as does project-related training.

Too little and too little rigor in evaluation. Well-designed evaluations, especially of institutional reforms, are very few. Accordingly, reliable information on the performance of the Bank's social sector investments is largely absent. Moreover, lack of rigor in the evaluation of institutional components and project impacts is particularly troubling.

The predicament of executing units. Projects create executing units mostly to overcome weaknesses in ministerial bureaucracies. However, the problems associated with executing units are widespread, and the experience suggests that they guarantee neither efficient nor smooth execution. Across the region, high staff turnover in executing units hampers project implementation.

The procurement and contracting conundrum. The administrative requirements of Bank loans are often at odds with the institutional capacities of clients along a broad swath of countries and sectors, but the problem can be especially acute for social sector projects, where small private sector agencies increasingly execute project components. Procurement rules and contracting regulations, designed originally for large bureaucracies, often delay project implementation and do not necessarily guarantee accurate accounting, transparency and efficient use of resources. In addition, these rules contradict the underlying logic of lending modalities designed for quick disbursement and flexible implementation.

Mainstreaming requires more than mandates and technical competence. While the emphasis has focused on beefing up internal IDB mandates, accountability and technical competence, successful mainstreaming of cross-cutting social issues—such as gender and inclusion—depend as well on larger, contextual factors. Thus, the composition of the Bank portfolio influences the probability of mainstreaming, since emergency and sector loans provide fewer opportunities for mainstreaming than regular investment operations, while a portfolio weighted towards social sector and poverty operations provide more opportunities. The priority that borrowing member countries give to these issues (which, in turn, affects the countries' institutional capacity), the strength of the advocacy movements and corresponding influence on policy are also major factors.

Clients Views

The Bank sought opinions of its operations in the social sectors from telephone interviews with a sample representing 274 clients directly involved with Bank projects in 26 member countries and complemented this analysis with face-to-face interviews with close to 50

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

clients in four countries. In addition, some of the same questions were asked in an anonymous survey to Bank operational staff in the social sectors.[5]

Overall, perceptions of IDB's performance concerning financial and nonfinancial products were positive, especially in social infrastructure and education in relation to other areas of Bank lending. Respondents expressed that providing continuity of reforms and mediating among different actors competing for scarce resources were important functions of the Bank. There was high regard for the Bank's technical assistance, new financial instruments and the availability of grants for social development. Grants were seen as critical to finance innovations, studies, institutional strengthening and stimulate participation, and there was concern with reductions of grant funding.

Respondents strongly welcomed more "customized" projects, using more local talent and knowledge in project preparation, and desired full partnership with the Bank in customizing reform processes that respond to particular country features and needs. Projects should have longer time frames. Interventions should be flexible. Large projects were unsurprisingly perceived as difficult to execute and there were calls for more help with innovative social projects.

A majority felt that Bank procedures for social sector operations were complex (74 percent) and time consuming (67 percent), thereby hindering performance and highlighting the importance of revising procedures. Sixty seven percent considered that impact evaluation was very weak and needed reinforcement. These issues are addressed in section 5 of this document.

In addition to obtaining clients' views, the areas of Bank action mentioned below benefited from face-to-face consultations with, among others, indigenous women leaders, labor union representatives, civil society organizations[6] and governments. Consultations were held with the World Bank, ECLAC and European donors, underscoring the importance this document places in donor coordination

---

[5] The universe of the telephone poll by Gallup included a list of 274 clients from 26 Bank member countries divided between government leaders and civil servants (70 percent), civil society and private sector (15 percent) and others. Sixty five percent were men. Clients represented education (18 percent), health (15 percent), other social sectors (31 percent), economy and finance (16 percent), political leadership (7 percent) and others. The telephone poll was con-ducted on a random sample of 150 names from this universe (with an 8 percent sampling error). The face-to-face interviews were done in Bolivia, Jamaica, El Salvador and Venezuela. 41 Bank social sector specialists, half of them in the Country Offices, answered the anonymous survey.

[6] There was a regional meeting as well as additional consultations in Brazil, Chile, Costa Rica, Jamaica, Mexico and Paraguay.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



AREAS FOR BANK ACTION

Based on the foregoing analysis of the region's social development challenges and the lessons learned, the Bank proposes four sets of priority actions to help countries accelerate social progress in supporting the attainment of the MDGs. They call to:

- Customize the Implementation of Reforms in Health, Education and Housing;
- Implement a Human Development Agenda over the Life Cycle;
- Promote Social Inclusion and Prevent Social Ills; and
- Deliver Integrated Services with a Territorial Focus.

In line with the strategy's objective, these actions will pay special attention to enhancing the capabilities and opportunities of the poor and excluded for reasons, among others, of gender, ethnicity, race and disability.

Underlying these proposals is the conviction that a cross-sector approach to social development is essential and that together they provide a strategic framework for the Bank's dialogue with the countries. These proposals do not, however, substitute for sector-specific strategies and guidelines, nor do they identify, ex-ante, priority actions for individual countries that clearly require case-by-case consideration. This document offers directives to establish country-specific, measurable social priorities in the IDB Country Strategy Paper and the country programming process. These country priorities should be implemented guaranteeing adequacy of social expenditures; transparency of procedures; evaluation of outcomes; and social participation. They also presuppose that effective policies for sustainable economic growth and comprehensive poverty reduction are in place. Annex 1 summarizes the links between these four priority actions and the overarching objectives above mentioned.

Importantly, these proposals need to feed into country-driven comprehensive national poverty reduction strategies, including the poverty reduction strategy papers (PRSP) prepared within the context of the HPIC initiative and Country Poverty Papers, and be closely coordinated with those of other donors.

The Bank will actively promote a country programmatic focus, where donor actions in social development are coordinated in support of: (i) a common agenda of social sector reforms for social development; (ii) priority recurrent (non salaried) public goods expenditures and investments; and (iii) a parsimonious set of result and impact indicators, linked to the MDGs, which can be monitored on a periodic basis. Donor disbursements, then, would be conditional on achievements in these three categories: reforms, social expenditures and result and impact indicators. The Bank will further assist countries in developing a set of suitable social indicators to measure progress towards the MDGs, in coordination with ECLAC, UNDP and other international agencies.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

CUSTOMIZE THE IMPLEMENTATION OF REFORMS IN HEALTH, EDUCATION AND HOUSING

The Bank will continue assisting countries in reform processes, particularly those aimed at the goals of universal and more equitable access and that feature the MDGs as key objectives for the reforms. In doing so, it will be guided by the following precepts:

Understand the politics. The principles presented in the Bank's 1996 Strategy for Supporting Reform in the Delivery of Social Services remain sound and the Bank will continue to promote them. They are: getting the incentives right (by clarifying objectives, encouraging multiple sources of supply, rewarding favorable outcomes, and approaching decentralization with caution); taking into account the politics of bureaucracies in assessing reform readiness; paying attention to implementation; and including social marketing components. Within this frame, the Bank will emphasize institutional and political analysis of the factors bearing on the reforms at the country and local levels.

Seek consensus, use local talent, and set realistic and explicit objectives and time frames. Among other actions, the Bank will help design consultations and social dialogues among key stakeholders to help shape the objectives and tracking mechanisms of the reforms, and also build political consensus and long-term support for them. (For more details on best practices in social dialogues, see Box 3). It will break down complex reform processes into more manageable tasks or stages and will define measurable, realizable objectives for each stage. It will set realistic time frames and rely on local talent and knowledge as much as possible to define and implement these objectives. Measurable objectives will guide designs, with more flexibility on intermediate steps. Measurable intermediate objectives will be clearly linked to final efficiency, effectiveness and equity objectives. Objectives and results will be widely disseminated to the public to promote transparency and accountability.

Tailor reforms to respect and include cultural diversity. Health, education and housing reform objectives as well as service provision need to be tailored to incorporate the cultural richness of diverse ethnic and racial communities throughout the region with a view to increasing both access to and utilization of quality services by these communities.

Promote good management practices. The Bank, through INDES and other training instruments, will continue to support the development of sound, strategic management practices and to develop leadership in organizational change in key government and non-government organizations.

Provide financing options. Countries vary widely in their distance to the goal of universal coverage of basic social services and in the mechanisms for financing them. Both public and private resources must be tapped in country and sector-specific suitable mixes need to be promoted. The Bank will assist countries in designing financing options and in seeking broad national consensus on the public financing of social services as well as on the nature and financing of social insurance and pension mechanisms. Importantly, the Bank will seek to mobilize public resources by promoting effective tax systems. It shall also encourage countries to increase the efficiency of social expenditures and both enhance the portion of social expenditures benefitting the poor and protect these expenditures in periods of crises and fiscal retrenchment. In addition to these general recommendations, the Bank will also promote sector specific activities:

Reforming Health. The Bank will emphasize health reforms linked to country specific

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

health needs and objectives, incorporating the MDGs. It is important to underline that health reforms are not end in themselves, but only instruments to achieve health goals. Considering the country's epidemiological profile, this approach will stress either injuries, noncommunicable or communicable diseases. In countries where communicable diseases predominate, the Bank will focus attention on maternal mortality; infant mortality and morbidity; and communicable diseases, especially AIDS, malaria, dengue, TB and other infectious diseases, emphasizing a gender perspective in service delivery and utilization. This approach should also improve coordination with other Ministries.

Phase health reforms according to country possibilities. Each reform needs to be tailored and phased according to the social, institutional and financial possibilities of the country. Consensus building as a key element to launch reforms deserves greater effort.

Raise the profile of public health. The Bank will help to increase the effectiveness of reforms on the public health system in preventing and control the above-mentioned health conditions and improve its relationship to the health delivery system. It will promote rising the role and visibility of public health and primary care, improving health risk prevention and the promotion of health and healthy lifestyles as a national policy.

In addition, the Bank will assist in: (a) *promoting the efficiency* of public resources expended in health, increasing the efficacy and effectiveness of health budgets. (b) *Reducing health gaps* between rich and poor using public resources to target basic health needs, tailoring services to increase access and utilization, and monitoring implementation to raise quality of service provision. (c) *Promoting community based health systems.* (d) Promoting decentralization of health services, through more autonomous local management. (e) *Reducing inadequacies in human resources, infrastructure and supplies*, by supporting suitable policies and placing more emphasis on reforming human resources training and linking it to the overall health reform process. (f) *Achieving a better balance between disease prevention and control*, by better inclusion of risk factors in the financing arrangements, and addressing costly unhealthy behaviors, such as obesity, sedentary life, tobacco and alcohol consumption, which are increasingly important challenges to the health status of LAC population.

Reforming Education. The Bank will assist countries in fulfilling the education MDGs mentioned in this document emphasizing *the objectives of equity and quality tailored to conditions at the country level.* In supporting education reforms across the region, the Bank will tailor its approach to country realities, including the timing of reform, the capacities of responsible institutions, and prevailing economic and educational conditions. Attention will be given to ensuring sustainable financing of the most cost-effective mixes of inputs, processes and incentives to raise student achievement and retention in school, as well as on increased equity through targeted interventions, including pre-schooling. The Bank also will act to strengthen assessment systems, statistics, and coordination with other donors to leverage, target and maximize scare resources for reform at the country level. More specifically, the Bank will:

Support secondary without abandoning long-standing commitment to primary. In regions at risk of not meeting the primary schooling MDG, the Bank will work to enfranchise marginalized populations by expanding access to and permanence through the primary level. For secondary education, it will assist countries in meeting complementary development goals of coverage of secondary schooling for 75 percent of youth. It will fund capital costs for expanding access emphasizing quality improvement, increased

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

equity and efficiency, sustainable financing and better school management. Given the constraints on additional public funds to education, the Bank will explore options to leverage and bring the resources of the private sector to bear on education, provided equity considerations are met. The Bank should also support the capacity for public oversight to guarantee standards of high quality in public and private provision.

Promote schools as the locus of reform. In line with country conditions, the Bank will focus on reviving the school as an active sphere of management, innovation and social responsibility through increased autonomy, intense community participation and judicious decentralization and local government involvement. The Bank will encourage school autonomy and processes that give more decision-making power, financial and pedagogic, to schools.

Advance better quality inputs. The Bank will increase support to the pre-and in-service training of teachers by focusing on innovative and cost-effective programs. It also will support incentives to attract higher quality teachers and analytical work and programs to improve teacher incentives and accountability at the school level. The Bank will also support a prudent but intense application of the potential of technology to expand coverage and improve quality, especially through the radio and television, as well as through pilot programs in the use of computers and the Internet.

Explore new options for higher education. The Bank will support ongoing efforts to diversify the supply of tertiary education; make its delivery more efficient; and reassign educational budgets in favor of and increase access for previously excluded populations. On one hand, the Bank will support the modernization and streamlining of internal structures in the region's public and private universities and work with them to strike a balance, different for each institution, between teaching, research and the provision of services to constituencies (e.g., productive sector) beyond the walls of academe. On the other hand, the Bank will support efforts at the tertiary nonuniversity level (e.g., along the lines of community colleges) that are well aligned with the market's demand for skilled labor contributing to increasing competitiveness and achieving greater economic growth.

Reforming the Housing Sector. To further the attainment of the MDG of reducing the population living in slums, the Bank will continue supporting housing reform to improve the living conditions of low-income households, enhance sector effectiveness and promote sector-wide allocative efficiency of housing and related markets. Bank interventions will stress the need to solve the shelter problems faced by urban and rural low-income populations as part of a comprehensive system that ensures solutions to other socioeconomic groups that also need housing. Given the significant economic impacts of the sector, the Bank will promote a *two-pronged approach that simultaneously seeks to improve the existing housing stock and the urban services available to them and expand the production of affordable new houses.*

Improve the existing housing stock. The Bank will assist in upgrading substandard low-income settle-ments and support progressive housing construction. This calls for a comprehensive approach that package a variety of interventions—infrastructure, tenure regularization, technical and financial support for home improvements, and expansion of social services in urban neighborhoods and rural communities.

Expand affordable housing by improving the operations of mortgage markets, land markets and the efficiency of the construction industry. (a) To ensure adequate financing, the Bank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

will promote mortgage issuers to go down market and develop second tier mechanisms for housing finance. It will promote innovation in credit finance, such as housing microfinance—small, short-term loans for a wide variety of low-cost housing solutions and improvements—to meet the needs of the low/moderate-income majority, who generally cannot afford high-cost finished housing solutions. It will pay special attention to the needs of female-headed households and ethnic and other excluded groups. (b) The Bank will promote actions to strengthen the operations of land markets and facilitate the production and sale of affordable urban land. Among others, it will seek to expand investment in urban infrastructure to increase the supply of serviced land; establish public-private partnerships to develop land; promote the rehabilitation of deteriorated urban areas and the recycling of empty urban land; promote greater transparency in land markets; and introduce land use and subdivision regulations to develop low-cost and environmentally sound residential land. The Bank will also support government efforts to improve technology and capacity in the construction industry.

Promote the efficient use of public funds to support of the housing sector. Bank sponsored operations will consider that the use of public funds to provide subsidies (up- front, transparent, budgeted, and targeted to households in need) is a policy tool suitable after other means of attaining the objective of facilitating housing access to low-income households have been explored and proven insufficient to reach the low income groups. Public funds may also be used to improve the regulatory environment of the building industry, develop efficient land market regulations and improve the transparency of land markets. These uses may be more effective than direct subsidies in attaining the objectives and, more importantly, in ensuring that they are sustainable after public resources are exhausted.

IMPLEMENT A HUMAN DEVELOPMENT AGENDA OVER THE LIFE CYCLE

Promote a life cycle perspective. The widespread human developmental failures noted in the diagnosis section have serious consequences both for the growth and competitive prospects of countries and for efforts to reduce poverty. In response, the Bank will assist countries in implementing a human development agenda using a life cycle framework. This agenda is closely linked with and should further strengthen the reforms in health, education and housing by providing concrete reform objectives and stimulating synergies between the reform processes. It will privilege successful transitions between key stages in the life cycle of individuals and families and define and track the performance of outcome indicators. Basic principles include invest in the accumulation of human capital early and continuously; emphasize a gender lens; target critical transitions; integrate institutions to support successful transitions; promote equality of opportunities for all; and measure results.

In particular, the Bank will pay special attention to supporting and following the life trajectories of *disadvantaged individuals and families.* It will assist countries in devising social indicators—disaggregated by age, gender, race and ethnicity, disability—that can measure the combined impact of interventions. It will encourage countries to collect panel data using household surveys and administrative records to track progress towards successful transitions.

Insure successful transitions between life cycle stages. Interventions to insure successful transitions are especially important in the following six stages in the life cycle of individuals: pregnancy and birth; infancy through preschool; from early to middle childhood (and transition into primary school); adolescence (and transition to secondary school); transition to adulthood (and both family for-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

mation and the workplace); and the post-retirement years. Similarly, there are critical transitions in the family life cycle for which low income households, in particular, need support: from single individuals in parental households to family formation (access to housing); through family growth (home expansion and improvement) and migration; and to family reduction (housing contraction). The Bank will assist countries in providing the infrastructure and incentives needed for institutions to increase successful life cycle transitions. While the combination of supply-and demand-side interventions will vary according to the particular requirements of the country, the Bank will promote a package of quality services to help ease the transition between life cycle stages with the aim of universalizing service provision and reducing the inequality of opportunities created by failed transitions. Table 1 suggests some basic components of this package. Among these, reduction of malnutrition, labor training and pension systems are further elaborated below.

Banish hunger, reduce malnutrition and enhance early opportunities. Within national frameworks of poverty reduction and economic growth, the Bank will support countries in their efforts to eliminate hunger, improve food security and develop appropriate feeding practices for high risk populations, children in particular. These support measures could include, although would not be limited to, conditional transfers; nutrition education; institutional strengthening; community based interventions; epidemiological surveillance; micronutrient supplementation and fortification; and impact assessments. Interventions for infants and small children should be designed using an early childhood development framework.

Develop inclusive and continuous employment and training systems. Life cycle transitions can only be supported within the context of more comprehensive national systems that allow workers to move easily between the worlds of work, education and training. In more global and changing economies, learning is not a one-time acquisition but a continuous process where skills and income can be increased overtime by a strategic combination of education, training and learning in the workplace. The Bank will assist countries in developing national systems of education and employment, which require, to start, *reform of training systems and institutions.* The Bank will assist with the implementation of labor intermediation systems that improve the speed and the match of workers to better jobs, paying particular attention to the access of women, excluded groups and youth to intermediation services. The elements of the reform of training and labor intermediation systems are detailed in the Competitiveness Strategy. The Bank should also promote the development of comprehensive national skill standards that are readily used by employers and by training and secondary-vocational education institutions. These standards are a powerful tool for promoting inclusion of excluded groups; they also increase firms'competitiveness by lowering the search costs for new employees.

Strengthen labor ministries. The Bank should promote more vigorously the reform and strengthening of labor ministries to enable them to lead and advance effective national labor market policies. Modern labor markets require labor ministries that can provide accurate labor market information and promote policies to continue to modernize the workplace as well as training and education systems. Labor ministries should be reinforced, changing the perception that their role is simply to manage labor conflicts.

Give more systematic attention to core labor standards. The Bank should give more attention to the commitments of member states to

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Table 1. Ensuring Successful Transitions: Some Key Interventions in the Life Cycle

Stage	Services to be Promoted
Pregnancy and Birth	1. Improve access to and demand for quality reproductive health 2. Improve access to and demand for quality maternal and child nutrition 3. Seek the integration of reproductive health and MCH services
Infancy through preschool	1. Expand access to nutrition and early childhood care and development interventions 2. Work towards universalizing preschool education 3. Foster the coordination of services directed to infants and young children
Early to middle childhood	1. Ensure successful completion of primary schooling by all children 2. Increase quality and reduce gaps between poor and non poor 3. Ensure adequate nutrition for poor children
Adolescence	1. Work towards the successful completion of secondary schooling for all 2. Improve quality and reduce gaps between poor and non poor 3. Promote training in conflict management skills, life coping and social skills, with special emphasis in gender issues 4. Promote after school youth programs, emphasizing community activities and sports
Transition to adulthood	1. Facilitate successful transition between school and work with effective skills training and labor market information and intermediation services, with special emphasis on women 2. Implement life long learning initiatives that help move adults easily between work, education and training 3. Support responsible parenthood 4. Ensure quality child care arrangements for working mothers 5. Design innovative health and savings/social insurance mechanisms tied to workers rather than jobs
Post retirement years	1. Promote productive aging 2. Design gender-friendly social insurance and pension systems that expand coverage and build in long term financial viability

Sources: Furstenberg, F. 2002. Human Development Through the Life Course: An Institutional Perspective. Background paper for the Social Development Strategy, Inter-American Development Bank, Washington, D.C.

the core labor standards (CLS) (prevention of forced labor, child labor, and discrimination and the right to free association and collective bargaining) advanced by the International Labour Organization (ILO). Support for these standards can contribute to the achievement of the Bank's development and poverty reduction agendas, especially in the areas of reducing income inequality and inhumane working conditions. The Bank should develop best practices or guidelines regarding the CLS. They should include a discussion of the role of the CLS in Bank-sponsored policy dialogues, programming, projects, procurement, and both poverty reduction and competitiveness strategies.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Support healthy working environments. The Bank should support the implementation of ILO recommendations on occupational and safety health, helping countries develop better institutions for regulating, monitoring and delivering services to prevent injuries and deaths in the workplace and diseases related to labor.

Promote comprehensive and sustainable pension systems. Providing adequate pensions is essential to improve equity and complement short-term social protection. In addition to the challenges imposed by demographics and the growing informalization of work, the systems in place have serious inadequacies. "Pay-as-you-go systems" are prone to funding shortfalls that often exacerbate fiscal deficits, reduce the value of pensions or both. Compulsory capitalization systems are often over-regulated, entailing high administrative costs that sap net investment returns. In addition, they can be quite vulnerable to violent swings in net asset value in volatile financial markets. The Bank should, therefore, assist countries in designing comprehensive and sustainable pension systems. It should pay particular attention to gender issues, given both the different nature of women's and men's work and the differential mortality rates between them, as well as coverage of the lowest income workers in agriculture and the informal sector.

Tailor pension reforms to local socioeconomic and institutional features. The Bank will support suitable tailored reforms to expand coverage to the working poor and protect the rights of individuals who contributed to pension systems. Options need to be tailored according to countries' socioeconomic and institutional features. These options could combine basic pensions sustained by fiscal budgets, for the poorest workers, with feasible and self-sustained contributive systems for those in the formal labor market. They could also consider adopting "pay-as-you-go" or capitalization systems (based on collective funds or individual accounts), tailored to particular fiscal and institutional country features. Independently from the option adopted, general recommendations should be followed such as fiscal sustainability, transparency and efficiency, reflected in low administrative and transactional costs. Special attention needs to be paid to pension systems based on privilege. To avoid unfair and unsustainable situations, the Bank will promote the actuarial balance of all public funded "pay-as-you-go" systems, so that they do not generate pressures on public debt.

Enhance pension coverage for the elderly poor, especially in rural areas. The Bank, observing fiscal sustainability criteria, shall promote the creation of noncontributive pension systems especially in rural areas. These pensions should be particularly relevant for rural women, who most often have spent their working lives in unpaid agricultural production or the informal rural sector. Given higher mortality rates for males, many elderly women become heads of rural households without adequate means for survival.

Promote flexibility in regulations. Pension systems boost socioeconomic development by promoting social inclusion, protecting the elderly, and financing of long-term investment. To further these objectives, the Bank will promote shaping state regulations that avoid rigid investment portfolios on pension funds and increase flexibility on the size of contributions and benefits on the "pay-as-you-go" systems. This will avoid future deficits and maintain the long-term sustainability of the overall system.

Support the intergenerational feasibility of social policies. The Bank will assist countries in using accounting methodologies, which incorporate intergenerational effects to cost the financial requirements of a social agenda with a life cycle perspective. It will also assist

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

countries in generating broad societal dialogue and consensus for such policies, looking for the linkage between short-run social needs and their long term financing. This broad discussion should include the nature, coverage and financing of social security and pension systems.

PROMOTE SOCIAL INCLUSION AND PREVENT SOCIAL ILLS

The Bank will assist countries in increasing their capacity to fight social exclusionary practices and social ills. The Bank will emphasize strengthening the required data management capabilities; encourage partnerships between the public and the private sector, including businesses, NGOs, religious and grass root organizations, and the media; and play a leading role in coordinating with other donors working in these areas.

Promote Social Inclusion. One of the key failings of social and economic policies has been their inattention to excluded populations. The Bank, thus, will promote the social inclusion of all individuals who, because of features such as age, gender, race and ethnicity, disability, or migration status experience a structural lack of opportunities. It will assist countries in making public investments designed to correct imbalances in access of excluded groups to quality services and productive resources (land, capital, and technologies). The Bank should be cognizant, however, that patterns of exclusion, especially those based on race and ethnicity, are linked to particular historical and cultural circumstances which can vary between countries or subregions.

Make the invisible visible in statistics and research. The Bank will assist national statistical institutes and other entities responsible for national censuses and household surveys to collect and share information on excluded groups, in consultation with representatives of these groups. The Bank will promote policy analysis of race, ethnicity, gender, disability and migration, and the use of this analysis for the design of social policies. This includes policy research on the impacts of stigma and discrimination on individuals, families and communities.

Promote legislation, incentives and other instruments to combat stigma and discrimination. The Bank will assist countries in the analysis and technical development of civil rights and affirmative actions to promote diversity, prohibit discrimination, give preferential treatment based on merit and provide access to land titles and property, including security of land tenure and regularization of land titling, among others. These initiatives include laws and civil protection, as well as incentives aimed at broadening opportunities and addressing discrimination. (See Box 4 for examples of country initiatives in this area). The Bank will promote media and social marketing campaigns to alter cultural stereotypes, combat stigma and promote diversity and solidarity.

Strengthen institutions. The Bank will seek to increase the institutional capacity of agencies in the public and NGO sectors to foster social inclusion. It will assist in incorporating social inclusion in policy analyses and national plans for social development and poverty reduction.

Emphasize inclusion through labor markets. The Bank should design a new generation of labor market operations that place greater emphasis in increasing the labor market opportunities of excluded populations, including youth, women, indigenous peoples, afrodescendants and persons with disabilities, among others.

Tailor social and labor market services to increase access of excluded groups to quality

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Box 4: Government Initiatives to Combat Exclusion

In recent years, Latin American and Caribbean countries have launched a number of bold new measures designed to advance progress for traditionally excluded groups. They provide examples of the range of "tools" that are being tested in the region to address stigma and discrimination, and include among them:

- *Political Representation in Argentina:* Nine countries have followed *Argentina's* lead and have instituted quotas in political party lists to increase women's representation in the legislatures. In part as a result of quotas, women's presence in congresses rose in the late nineties by more than 50 percent. In Argentina, it went from 5 % in the Lower House of Congress to 28% after the law was passed in 1991.[1]
- *Education and Diversity in Brazil:* The government of Brazil provides afrodescendants with, among others, scholarships for higher education and preparatory courses to enter the Foreign Service.[2] A number of *Brazilian* public ministries have enacted quotas to ensure diversity in hiring of women, afrodescendants and persons with disabilities, both among public employees and public contractors.[3]
- *Land Tenure and Public Sector Hiring in Colombia: Colombia* has enacted quotas to ensure that women fill at least 30% of top decision-making positions in all three branches of government (legislative, judiciary, and executive branch) and local and regional offices.4 *Colombia's* law 70/93 on "Collective Land Tenure Rights" recognizes the rights of afrodescendant and indigenous communities to collective and community ownership of land.[5]
- *Indigenous Land Titling and Disability Benefits in Chile: Chile's* Law 19253 authorizes the State to transfer of land title to indigenous peoples in order to develop their communities. Under the law, the State assumes the responsibility of restoring unjustly expropriated land to indigenous peoples.[6] Law 19284 establishes, among other benefits, that the State will give priority to persons with disabilities when assigning subsistence/subsidiary benefits.[7]
- *Equality in Property Ownership in Costa Rica: Costa Rica's* Law 7142 establishes that all real property or goods, achieved or granted through social development programs, must be made in the name of both spouses and regardless of the type of marital union (e.g. includes common law marriages).[8]
- *Anti-Discrimination Legislation in Mexico:* An independent *Mexican* commission is working on anti-discrimination legislation that would be among the most comprehensive in the region, including provisions for, among others, people with disabilities, women, indigenous populations, and sexual minorities.[9]

---

1. Htun, M. 1998. Women's Political Participation, Representation and Leadership in Latin America. Washington, DC: Inter-American Dialogue.
2. Heringer, R. 2002. The Challenge of Practice: Affirmative Action and Diversity Programs in Brazil and the US. Presentation at the Woodrow Wilson Center for Scholars, 21 August, Washington, DC.
3. Heringer, R. 2002. Idem.
4. Government of Colombia. Law No. 581, *http://juriscol.banrep.gov.co.*
5. Inter-American Commission on Human Rights. 1999. *Special Report: Third Report on the Human Rights Situation in Colombia," http://www.cidh.oas.org.*
6. Government of Chile. Law No. 19.253. *http://www.colegioabogados.org/normas/leyes/19253-indigenas.htm.*
7. Government of Chile. Law No. 19.284. *http://www.dredf.org/symposium/chile1.htm.*
8. Government of Costa Rica. Ley de Promoción de la Igualdad Social de la Mujer. Law No. 7142.
9. Rincón Gallardo, G. 2002. Presentation at the Inter-American Development Bank, 20 June, Washington, DC.

services and jobs. The Bank will use social and cultural analysis in the design and provision of services to diverse groups paying special attention to increasing women's labor market opportunities; it will tailor labor market intermediation and training to increase these groups' access to quality jobs and reduce labor market discrimination, as well as insure that training programs effectively reach and target excluded populations.

Enhance corporate social responsibility. The Bank will engage the private sector more forcefully as an important partner in promoting, assisting and financing the social inclusion agenda. This includes efforts to use private and NGO providers, as appropriate, to deliver social services; work with private sector firms in expanding access of the excluded to work opportunities; engage the private sector in national campaigns to address labor

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

market discrimination and participate in national dialogues on social inclusion; and seek partnerships with innovative private firms to promote corporate social responsibility more widely in the private sector (in consistency with the Competitiveness Strategy.)

Prevent Social Ills. The Bank will assist countries in the reduction of social ills including child labor, crime and violence and HIV/AIDS. More cost-effective prevention will be privileged over control and remedial measures (cognizant, however, that prevention and control are two ends of a continuum rather than mutually exclusive categories). It will privilege early intervention; social as well as situational prevention strategies; epidemiological risk assessments; and the design of integrated responses, which consider phasing responses in stages and acting on more malleable factors first.

Reduce child labor. Investments should include: (i) supply-side interventions which decrease the supply of child labor, such as targeted scholarships for school attendance, waivers of school fees, school-work combinations that provide for skill acquisition, and microcredit financing for families conditional upon school attendance; and (ii) demand-side interventions which discourage firms from employing child labor, such as product labeling, voluntary codes of conduct, and industry-wide councils. Special attention will be paid to eliminating exploitative and hazardous forms of child labor.

Prevent domestic and social violence. The Bank will assist countries in the prevention of *domestic and social violence* by: (i) *developing information systems* that allow for the tracking of trends and the design of policy. These systems will be geo-referenced and will involve the participation of important stakeholders such as police, justice, and health sectors. The Bank will also support the development of the analytical capability necessary to make effective use of the data produced by these information systems; (ii) *financing primary and secondary prevention initiatives* in education, health, and the media. These initiatives will be designed to change behaviors and attitudes that promote violence and, in cases which it has already emerged, the violent behaviors themselves. Examples of interventions include teaching peaceful conflict resolution skills in primary and secondary schools, screening for victims of violence in health care settings, and enlisting the media as an ally in transmitting pro-social messages; (iii) *promoting situational crime prevention initiatives.* These initiatives include modifications to physical environments such as the redesign of streets and public spaces, increased street lighting, and video surveillance; (iv) *financing domestic violence prevention and treatment services* to ensure quality and coverage and reduce prevalence; (v) *promoting preventive policing*, including problem-oriented and community policing. Problem-oriented policing has been shown to be effective in reducing crime rates in the cities in which it has been implemented. Community policing has been able to reduce residents' fear of crime and their willingness to collaborate with police forces.

Reduce the spread of HIV/AIDS: The Bank will assist countries by: (i) supporting policy research on key areas, for example, resource needs and financing, stigma and discrimination, trends in adolescent sexuality, and best practices for prevention in excluded populations. These research findings will be used to raise awareness of HIV/AIDS issues among policy makers; (ii) developing prevention interventions that support the MDGs focus and the recommendations from the Johannesburg Sustainable Development Conference on reducing HIV incidence among youth, in particular between the ages of 15 to 24 years. The Bank will actively support work place interventions and HIV/AIDS initiatives aimed at indigenous and afrode-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

scendent populations; (iii) developing initiatives that reduce the stigma of HIV/AIDS and the discrimination experienced by persons living with HIV/AIDS. Stigma and discrimination have been shown to weaken the thrust of prevention and care interventions; and, (iv) supporting increased access to treatment and care. The Bank should finance the purchase of anti-retroviral medications and the strengthening of the laboratory infrastructure needed to monitor drug effectiveness. The Bank should collaborate with specialized regional and international agencies in these efforts.

DELIVER INTEGRATED SERVICES WITH A TERRITORIAL FOCUS

To provide effective responses to the multiple disadvantages of the poor and excluded and the many risk factors behind social ills, the Bank will assist countries in the implementation of integrated interventions in specific territories. Poverty is commonly concentrated in spatially segregated territorial areas—in either low-income slums or rural municipalities with high levels of unmet basic needs. A spatial focus facilitates diagnosing specific community needs, tailoring services, executing actions and doing impact assessments. Because these are a "new generation" of projects that aim to upscale successful local development initiatives, the Bank will include adequate monitoring and evaluation components and assess both potential benefits (lower administrative costs, improved targeting, strengthening social capital, empowerment, and improved transparency) and potential drawbacks (high up front project preparation and consultation costs, high opportunity costs for local leaders and time costs for women participants, and capturing of project benefits by elites).

Programs with basic features. Based on accumulated experience, the Bank will promote integrated programs that: (i) *invest in multiple sectors*, including basic infrastructure and social services and offer a menu of services that can be tailored to the needs and aspirations of individual communities (ii) *give attention to governance and organizational issues*, including adopting results-based management, so as to ensure transparency in decisions, accountability and adequate inter-institutional coordination mechanisms; (iii) *empower the beneficiary communities*, through their active participation in decision making regarding project design, as well as in implementation and supervision; and (iv) undertake appropriate *socio-cultural assessments* of potential beneficiaries to identify the different stakeholder groups, including the more invisible ones. (v) In addition, the Bank will seek to *maximize successful inter-agency coordination*, striving for simplicity, among others, by reducing the number of collaborating agencies, using multi-phase operations, and dividing implementation phases among agencie.

Promote complementary national policies. When implementing projects with a spatial focus or target, the Bank will be aware of, and guard against, potential further segregation and stigma derived from targeting the poor. The Bank will encourage complementing the delivery of comprehensive interventions in a territory with national policies that address the structural determinants of the poverty of excluded groups by expanding their access to economic opportunities and protecting their rights.

Support urban neighborhood upgrading projects. The Bank will enhance its assistance in the provision of integrated services to informal settlements or slums, which comprise between 20 and 50 percent of the urban population in the region. Through these interventions, it should seek to integrate the informal to the formal city, promoting citizenship and social integration of neighborhoods

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

by providing residents with the same services available to the rest of the city.

Bank projects will implement a *minimum package* of key physical infrastructure, including water supply, sewerage, street systems, drainage, environmental protection, property regularization and land titling, which can produce important improvements in the quality of life for the neighborhood. In addition, projects will provide social services such as day care centers, services for vulnerable or at risk groups, professional training, support for the management of productive units, continuing education for work, and income promotion. Merging urban infrastructure and social services create synergies that maximize project impact.

Support integrated community development projects. Because of geographic isolation, cultural and linguistic barriers, and values and priorities that may be different from those of mainstream society, indigenous people and afro-descendents have special difficulties in negotiating equal participation in society at large. In response to these barriers, the Bank will continue to support community-driven, integrated development projects in rural areas and marginal neighborhoods in urban peripheries as a vehicle to both raise the productivity of marginalized territories and enhance excluded groups' opportunities to negotiate with and participate in mainstream society. Food security, security of land tenure and regularization of land titling should be important components in these interventions.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

OPTIONS FOR BANK SERVICES AND IMPLEMENTATION GUIDELINES



The Bank has a variety of lending and nonlending instruments to address social development issues. The lending portfolio includes financial products such as investment loans (traditional, innovation, multi-phase), sector loans and emergency loans. In addition, the Bank uses technical cooperation projects using grants or reimbursable funding to support smaller activities. In the social sectors, grant or non-reimbursable technical cooperation has been used to highlight new and emerging issues, support studies and consensus building as part of project preparation, and develop implementation experiences.

The nonfinancial products can be grouped under two main headings: (i) *technical assistance for developing analytical tools* such as situational analyses, social data management, social surveys, research papers, pilot studies and development of evaluation mechanisms for social indicators and (ii) *training and consensus building for the implementation of social policies*, including seminars for dissemination and discussion of social policies; social policy dialogues; training in managing social policies and in the analysis of social issues; and best practices.

Many of these instruments were designed prior to the expansion of the portfolio. With the growth of this portfolio and corresponding experience, the Bank has come to further recognize the complexity of the region's social development issues, including some that the IDB and other development agencies had not explicitly considered. Social exclusion, racism, domestic violence and HIV/AIDS are clear examples of topics that have only recently been systematically addressed.

To successfully implement the present strategy, the Bank's approach to social projects must be strengthened in six aspects: project preparation; project design, implementation and evaluation; financial products for social projects needs; technical assistance; research, development and promotion of best practices; and resources to support work on innovative new social development issues.

PROJECT PREPARATION

The principles and recurrent themes promoted in the strategy should imply re-thinking the Bank's modus operandi in the social sectors and strengthening cross-sector approaches already being used. For example, in many cases, the life cycle perspective cannot be accommodated within a single project but suggests a more comprehensive framework where one or more projects consider the various stages of human development and focus on synergies across sectors or projects.

Country Strategy Papers (CSP) guide the thrust of the Bank's lending program and non-lending activities at the country level. During the nineties, they mainly focused on the macro-economic aspects of country assistance. Analysis of social development issues was limited, and, therefore, the CSP did not provide an adequate platform for sufficient agreement with governments on social actions. In addition, country strategies were commonly set without significant participation of stakeholders in the respective countries. The Bank is improving the CSP preparation to fill these absences and the present strategy should support this effort.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

To support this process, operational procedures should be enhanced by: (a) making the CSP the core instrument to strengthen the treatment of social development issues; (b) increasing the background research done in social sectors for the CSP as well as the use of seminars and social policy dialogues that involve relevant social actors to help establish social priorities during the pre-programming and programming phases of the project cycle; (c) strengthening the diagnosis of social issues and corresponding agreements with governments by more extensively incorporating the substantive findings from research, social policy dialogues and seminars in the CSP; and (d) mainstreaming discussion of cross-cutting social development issues, including gender, social inclusion and core labor standards, into CSP and surrounding dialogues with the country regarding the development of the country portfolio.

PROJECT DESIGN, IMPLEMENTATION AND EVALUATION

Design. Projects seeking social progress must conform to local realities and incorporate local resources far more than in other sectors. Many of the common setbacks in the implementation of social projects can be traced to failure to heed these precepts, especially at the design stage. The strategy entails a wider use of participatory vehicles to gather information on local conditions and greater use of local consultants to assist in the formulation of activities and implementation arrangements.

Implementation. Counterparts in borrowing countries and Bank social sector specialists agreed on the Bank's important role in providing technical assistance for project execution. It is noteworthy that respondents singled out its assistance concerning compliance with Bank procedures. Indeed, clients and Bank staff agreed that the Bank's many rules are in part responsible for delays and lost opportunities in project execution. These are seen to be particularly daunting respect to procurement protocols originally designed for large infrastructure projects. To effectively work with social sector implementing agencies in the public and private sectors requires adapting procurement and disbursement rules to better fit their particular organizational features, strengthening rather than sacrificing accountability. The Bank should consider these issues in the ongoing overall review of Bank procedures.

Social Investment Funds (SIFs) should be mainstreamed into the governments' line social programs, insuring that their operations are coordinated to line ministries and that governments increasingly assume their financing. This is intended to guarantee their sustainability and demonstrate the government's commitment to the activities and modes of operation successfully introduced by the funds. Considering that a great number of works and services financed by the SIFs are municipal in nature, Bank operations shall emphasize decentralizing of project implementation, transferring resources for local governments to execute projects and involving beneficiaries in the decision-making and supervision of SIF projects.

Evaluation. Evaluating the impact of social development activities is not easy. The desired outcomes often entail long-term processes. Some of the issues addressed are difficult to operationalize and measure, for example stigma and discrimination associated with race, ethnicity, disability or HIV/AIDS status. Moreover, previously noted obstacles to the implementation of social projects result in more resources and attention being paid to initiating and sustaining activities than to evaluating their impact. However, evaluation remains a sine-qua-non condition for a successful portfolio of social development projects, particularly those seeking to improve the well being of people rather than

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

the physical infrastructure of, say, clinics or schools.

To improve the quality and number of evaluation studies, the strategy proposes: (i) increasing data collection prior to project interventions including the use of baseline and rigorous social evaluation methodologies; (ii) defining output, outcome and impact indicators during project preparation; (iii) strengthening evaluation capacity for social development projects, (iv) improving the monitoring of project progress; (v) strengthening the evaluation capability of national agencies; and, (vi) disseminating an evaluation culture through training activities sponsored by specialized units such as INDES and LRN.

FINANCIAL PRODUCTS

The Bank needs financial products that are better suited to the proposed social agenda. Successful social reforms require that the proposed innovations be tested before scaling up implementation. And since they entail long-run processes, the initiatives need to be phased, monitored and closely evaluated. Moreover, reform processes must be highly resilient to changing political and economic environments over long periods of time. Many Bank current operations in support of social programs do not meet these conditions in their design, thereby carrying high risks of failure during project implementation.

In the last decade, the Bank created new instruments to accommodate countries' changing needs, including multi-phase and innovation projects. They have yet to be extensively used for social operations, although sector and emergency loans have been increasingly used for social sector projects. As suggested by Bank clients and social sector specialists, multi-phased and innovation projects should be used more often for social operations because they conform to the pace of reform processes and their achievement of long-term development goals. In addition, the Bank should seek to actively develop other programmatic instruments for social sector operations.

In special contexts, emergency loans can help to ameliorate the impact of crises on social conditions or keep social services working during socioeconomic crises or natural disasters, as has been the case with the social expenditures protection components of some of these loans. Sustaining institutional reforms and protecting essential services for vulnerable groups are two important contributions that emergency loans can make to social development. In implementing these loans it is important, however, to ensure that both objectives are met. To verify the achievement of these objectives, given the fast disbursement nature of these operations, the strategy recommends the adoption of a simplified set of indicators, based on information already available and verifiable on shorter periods, i.e. monthly or quarterly. Yet, investment loans remain a principal vehicle for supporting social development goals and changes in social policies.

TECHNICAL ASSISTANCE

During the last decade, the Bank has increased the number of nonreimbursable technical cooperations (TCs) to address social issues. Nevertheless, the Bank still has few means to respond quickly to social sectors needs for the design of new diagnostic tools and the evaluation and monitoring of social programs. Bank TCs have shortcomings in their lengthy approval process, their limited flexibility in using consultants and firms, and, above all, the limited availability of grant funds. Especially at the country level, there are limited funds and instruments available for the Bank to rapidly respond to demand for support of innovative or pilot social development initiatives.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

The successful implementation of a social project depends heavily on the quality of the diagnosis, the skills of the project team, the strength of the information system and the mechanisms for social dialogue and consensus building. Most of these aspects need to be present during project preparation and many countries, particularly the poorest, cannot provide these inputs. Greater access to grant funds from technical cooperations is needed to facilitate these initial steps.

The Eighth Replenishment of the Bank's resources (paragraph 2.64) supported the establishment of a Technical Cooperation Fund that would: (a) facilitate efforts to attract additional resources and consolidate the funding and programming of technical cooperation operations; and (b) harmonize the utilization of the various sources of technical cooperation. The exploration of a possible fund for social projects could build on this recommendation and provide additional support for the social sectors.

The possible fund could complement existing Bank technical assistance instruments for social development by adding features currently absent, such as faster grant approval that can give more timely response to project preparation needs, including studies, social diagnosis, social dialogues, consensus building, and social project evaluation mechanisms.

RESEARCH AND BEST PRACTICES

On many of the social development issues emerging in the region, there is an insufficiently developed research literature; best practices are not always known or recorded; and access to what limited data is available is difficult, particularly for those living in the region. This strategy supports the conduct of applied research to improve project design and the identification of best practices. It also supports longitudinal evaluation research studies to assist the Bank in identifying the impact of its lending activities on social progress.

Equally important is the dissemination of research findings in the region and their incorporation in social policy dialogues and program planning. The Bank should continue to actively support dissemination of information on social development projects, and explore new Internet options for increasing access to information relevant to social development issues. The Bank will continue to utilize seminars, conferences and social policy dialogues as a means of building consensus on key issues.

ACTION PLAN

The Plan of Action proposed to implement the social development strategy can be summarized in the following points:

- Increase the use of research, seminars and social policy dialogues as part of the process to define social priorities in the countries during the pre-programming and programming phases of the project cycle;

- Strengthen the diagnosis of social issues in the Country Strategy Papers, supported by a wider use of participatory methodologies, and include clear actions for the social sectors.

- Promote donor and lending coordination in support of a programmatic focus, absent in current practice, tying disbursements to achievements in reforms, social expenditures, and indicators linked to the MDGs.

- Mainstream cross-sector and new social development issues (i.e., gender, social inclusion, and core labor standards) from the early stages of dialogue and programming.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

- Support the more widespread use of local collaborators and consultants, including community representatives, to assist in the identification of activities and design of implementation arrangements during project preparation.

- Stimulate the design of multi-sector social projects cognizant, however, of the need to devise mechanisms to facilitate and simplify implementation, by promoting a greater level of integration among complementary sector perspectives provided by the various functional divisions in the Bank.

- Increase the use of baselines and social evaluation methodologies and define process and impact indicators during project preparation. Encourage the collection and analysis of data with sufficient disaggregation to support targeted social policy.

- Strengthen evaluation and monitoring capacity in Country Offices and increase the budgets allocated for evaluation of social development projects during the preparation and execution phases.

- Review the Bank's procedures for social project execution and develop new approaches to address relevant questions such as contracting services, bidding and financial and accounting procedures; as well as the support for ongoing training to Country Office staff on social project execution.

- Increase the use of multi-phase and innovation projects and develop new programmatic instruments for social operations.

- Increase access to grant funds from technical cooperations for project preparation and to support the development of social country strategies; conduct applied research; improve project design; identify best practices; support dissemination of information on social development projects; and explore new Internet options for increasing access to information relevant to social development issues.

- Strengthen the evaluation capability of national and sub-national governments and disseminate an evaluation culture in training programs offered through Bank units such as INDES and LRN.

- Establish an ad-hoc working group to analyze a possible fund for social projects to respond to countries' needs for grant assistance in the social sectors.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



MONITORING, EVALUATION AND PERFORMANCE INDICATORS

This section provides suggested indicators to gauge progress in achieving the strategy's priorities. These indicators evaluate the impact of Bank projects in the social sectors as well as expected outputs and outcomes from Bank operations, and are linked with the MDGs. Outcome indicators should be based on OVE's evaluation of Bank's projects and TC. With the exception of the MDG's, for which there are world targets, quantifiable goals or values (percent changes) for impact indicators need to be established on a case by case basis.

OUTPUT INDICATORS

The indicators track the actions the Bank needs to undertake to help countries meet the social development challenges identified in this document. It is important to underscore that the establishment of causation between outputs, outcomes and impacts is fraught with methodological difficulties arising from the fact that a complex set of variables influence Bank outcomes as well as impacts. It is easier methodologically to attribute the effect of Bank outputs on outcomes than to measure the Bank's impacts.

Among others, the following output indicators are suggested to assess how well Bank procedures comply with the strategic directions in this document:

- *Weight of Bank lending for social development*, both in terms of percentage of total loan volume and in terms of percentage of number of loans. As mentioned above, social lending represented 39 percent of total volume and 37 percent of the total number of loans during the 1994–2001 period. During the implementation of this strategy, within this social lending portfolio there should be a rise in both the volume and the number of loans which are linked directly to the four main strategic priorities presented in this document as well as the achievement of the MDGs.

- *Increase in grant funds for social projects.* Nonreimbursable technical cooperation funds have been shrinking at the Bank in recent years, a trend that inhibits the Bank's ability to promote innovations in the social sector. This trend should be reversed using, among other efforts, possible new funds for social projects.

- *Proportion of innovation, multi-phase and new programmatic instruments in the social sectors.* Another important tool for promoting innovation and sustaining reforms in the social sector is the use of innovation multi-phase and other novel programmatic instruments. By 2005, Bank lending should exhibit an increase on the share of these operations in the social sectors.

- *Increased discussion of social development issues in Country Papers.* Since Country Papers establish Bank priorities at the country level, it is vital that social issues are analyzed and discussed in these documents. The Bank should, therefore, increase significantly the share of country papers that address substantial social issues.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

OUTCOME INDICATORS

To adequately assess the outcomes of Bank action it is necessary to carefully evaluate Bank social sector projects. These evaluations will permit fine-tuning of social projects over time and ensure that they are institutionalized and making the greatest possible contribution to the development of the region. Therefore, the Bank shall:

- *Improve evaluation components in social projects*: In the context of the current work on Development Effectiveness and after the approval of this document, a representative sample of social projects in the Bank should include sound evaluation instruments, such as baselines, surveys, case-control experiments and impact indicators.

- *Project results monitoring*: An evaluation methodology should be designed which specifically targets the evaluation of social sector loans and technical cooperations.

IMPACT INDICATORS

The Bank's actions should support the achievement of the Millennium Development Goals for reducing infant and maternal mortality; completing primary schooling, promoting gender equality and empowering women; halting the spread of diseases such as malaria, tuberculosis, HIV/AIDS, dengue; and increasing access to safe drinking water, improved sanitation and secure tenure. Bank-sponsored initiatives should also have an impact on the broader panorama of social development issues addressed in this strategy, including reducing the prevalence of domestic and social violence and child labor; increasing the inclusion of socially excluded populations; improving the quality of the housing stock, particularly for the urban and peri-urban poor; and fostering the social development of marginalized territories. Given the wide variability of conditions in the region, country-specific impact indicators need to be developed for each of the goals mentioned above.

An evaluation of this Strategy will be done five years after it is approved.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



ANNEX

Areas of Action for the Bank and their Relation to the Sustainable Economic Growth and Poverty Reduction Strategies

Areas Of Action	Link To The Sustainable Economic Growth Strategy	Link To The Poverty Reduction Strategy
A. Customize the Implementation of Reforms in Health, Education and Housing	**Social progress (Education, Health and Housing) as condition to economic growth**	**Reduction of inequities to access health, education and housing services**
Objective: Support social reforms; speed up social progress and reduce inequities to access social services	*Objective:* Social Progress highlighting the Millennium Development Goals.	*Objective:* Increase access for social services to the poor.
Subsections:	*Actions:*	*Actions:*
• Health	• Efficacy, coverage and quality on social services emphasizing primary health care.	• Health goals linked with poor and excluded needs.
• Education	• Promote universal primary education and strengthen secondary and post-secondary education.	• Extend coverage and quality of education to the poor.
• Housing	• Expand and improve housing stock.	• Promote housing opportunity to the poor.

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

Areas Of Action	Link To The Sustainable Economic Growth Strategy	Link To The Poverty Reduction Strategy
B. Implement a Human Development Agenda Over the Life Cycle	**Reduce barriers to human human capital development**	**Equal opportunities for all during the life cycle phases**
Objective: Human Capital Development to families supports critical transitions over the life cycle.	*Objective:* Human Capital Development.	*Objective:* Social protection for vulnerable groups during life cycle.
Subsections:	*Actions:*	*Actions:*
• Promote a life cycle perspective	• Improve successful transitions.	• Create social infrastructure to support the poor and vulnerable groups transitions.
• National employment and training systems	• Improve linkage between labor markets, education systems and training institutions.	• Create training institutions; labor intermediation systems and child care facilities to poor workers.
• Sustainable pension systems	• Improve efficiency, coverage, fiscal and financial balance for pension systems.	• Improve the social protection against economic risks and loss of labor capacity to poor workers.
C. Promote Social Inclusion and Prevent Social Ills	**Social Capital Development**	**Social Exclusion elimination by the generation of social capital**
Objective: Social Capital Development and Social Inclusion of the excluded groups	*Objective:* Social Capital Development	*Objective:* Integrate the excluded for better social development opportunities
Subsections:	*Actions:*	*Actions:*
• Information	• Promote information, research and policies to attend discrimination.	• Monitor progress among excluded groups.
• Legislation	• Develop legislation to combat stigma and discrimination.	• Guarantee access to opportunities for the poor and excluded.
• Institutions	• Incorporate social inclusion in policy analysis and national plans.	• Strengthen institutions to promote social inclusion.
• Labor markets and exclusion	• Promote efficient labor markets intermediation.	• Integrate labor markets with social and cultural features for excluded.
• Prevent social ills	• Reduction of economic losses generated by social ills.	• Prevent social and domestic violence and the spread of HIV/AIDS in poorest groups.

(continued on the next page)

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Areas Of Action	Link To The Sustainable Economic Growth Strategy	Link To The Poverty Reduction Strategy
D. Deliver Integrated Services with a Territorial Focus	**Local levels, Local economics and Social Development**	**Local and territorial levels as locus for poverty reduction**
Objective: Integrate Social Development Programs at Local Levels.	*Objective:* Social and economic development at local areas.	*Objective:* Target interventions to the poor at local level.
Subsections:	*Actions:*	*Actions:*
• Neighborhood upgrading	• Improve infrastructure for urban population.	• Integrated packages of physical infrastructure for the poor neighborhoods.
• Integrated community development projects	• Promote integration of isolated communities.	• Increase social economic development of indigenous, afrodescendents and rural communities.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

COMPETITIVENESS

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This document was prepared by an Inter-Departmental Working Group, coordinated by RES and SDS. Eduardo Lora (RES) coordinated the drafting of the document, with the participation of César Bouillón (SDS/POV) and Luis Fierro (SDS/SDS), under the guidance of Carlos M. Jarque (Manager, SDS). Contributions were received from Bank staff, including: Pablo Angelelli (SDS/MSM), Marcelo Antinori (RE2/FI2), Paulina Beato (SDS/IFM), Juan Belt (RE3/FI3), Martin Chrisney (RE2/FI2), Koldo Echebarría (SDS/SGC), Jaime Fernández (RE3/FI3), Juan José Llisterri (SDS/MSM), Pietro Masci (SDS/IFM), Jacqueline Mazza (SDS/SOC), Jaime Millán (SDS/IFM), Andrew Morrison (SDS/SOC), Alberto Paz (RE2/FI2), Nathalie Pazmiño (SDS/SDS), Emilio Portocarrero (DPP/SPO), Ricardo Quiroga (SDS/ENV), Alvaro Ramírez (SDS/MSM), Silvia Sagari (RE1/FI1), José Seligmann (RE1/OD1), Mario Umaña (RE2/FI2), Antonio Vives (SDS/PEF) and David Wilk (SDS/ENV). Suggestions and comments were received from other Bank staff and various consultative groups, composed of representatives of governments, academia, and civil society at the national and regional level, and comments received via the Bank's Internet website. This document also builds upon the 2001 Economic and Social Progress Report on Competitiveness: The Business of Growth prepared by RES, as well as the report Competitiveness and Building Consensus: Strategic Options for IDB Operations, coordinated by Martin Chrisney (RE2/FI2). The authors express their thanks for all these contributions.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

OBJECTIVE



Competitiveness is defined as the quality of the economic and institutional environment for the sustainable development of private productive activities and the increase in productivity. Enhancing the capacity of the countries to improve competitiveness is consistent with the key fields of Bank activity identified in the Eighth Capital Replenishment. It is also one of the four priority areas in the framework of the Institutional Strategy.

The improvement of competitiveness is essential for achieving high and sustainable rates of *economic growth*, provided it is supplemented by policies designed to increase the efficiency of the State, improve the provision of social services and strengthen the channels for integrating the economies with the rest of the world. The increase in competitiveness is also closely linked with the objective of *poverty reduction*. Given the low levels of per capita income in most of the countries of the region, significant increases in productivity will be needed to achieve a substantial reduction in poverty. The conditions for competitiveness are also intimately linked to the *environment*, since improvements in productivity are only sustainable if they lead to the preservation and improvement of the natural resource base.

The objective of this strategy is to contribute to improve the economic and institutional environment for the development of the private sector and increasing productivity. This strategy proposes actions that concentrate on correcting or compensating failures in the operation of the markets that are relevant for the competitiveness of the set of companies in the private sector. The proposed actions are organized into the following areas: (A) access to financing and mobilization of capital; (B) access to human resources, training and labor relations; (C) availability of infrastructure (roads, ports, energy, telecommunications, etc.); (D) access, assimilation and generation of new technologies and knowledge; (E) quality of the public institutions linked to the functioning of private productive activities; and (F) competitiveness and the productive and sustainable management of natural capital. These areas include specific actions to improve access to markets and competitiveness of firms in general, including micro- and small enterprises. Given the importance of macroeconomic stability and institutions for competitiveness, the Bank will also promote actions to strengthen macroeconomic policies, as detailed in the Strategy for Sustainable Economic Growth and to strengthen institutions and the Rule of Law, as described in the Modernization of the State Strategy.

This strategy is consistent and complements other Bank strategies in related areas, such as Small- and Medium-Sized Enterprises, Microenterprises, Financial and Capital Markets, Energy, Infrastructure, and Science and Technology. However, the strategy offers an integrated perspective and aims, in combination with the strategies for the other priority areas (Social Development, Modernization of the State, Integration, and Environment), to coherently pursue the central objectives of Poverty Reduction and Promotion of Equity, and Sustainable Economic Growth.

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub



DIAGNOSIS

With respect to the previous decade, in the 1990s Latin America and the Caribbean achieved important progress in competitiveness, as reflected in more buoyant exports in practically all the countries, in the inflow of direct investment capital which helped renew the productive sectors and in rates of economic growth that were higher than in the previous decade. Despite these and other achievements, considerable evidence indicates that the countries of Latin American and the Caribbean continue to face serious problems of competitiveness:

- In the 1990s, the average annual growth of the countries of the region was only 3.3 percent, lower than that achieved by other groups of developing countries, such as South-East Asia, which grew 5.1 percent. Considering demographic growth, per capita income increased only 1.5 percent per year, insufficient to reduce the income gap with the developed countries or to achieve the Millennium Development Goal for poverty reduction. The results in the initial years of the current decade have not been more encouraging.
- In many countries of the region, the productivity of capital resources (physical and human) has been falling. While the stock of physical capital grew at an annual average of 2.6 percent and 3.7 percent during the eighties and the nineties, respectively; overall factor productivity decreased at an annual average rate of 2.65 percent and 0.62 percent during the same periods. These trends reflect changes in the global economy characterized by increases in the gaps of productivity between rich and poor countries. While productivity in developed countries, Eastern Europe and the rest of Asia increased at an annual average rate of 0.56 percent, 0.82 percent y 0.69 percent respectively, during the last decade; in Southeast Asia, the Middle East, and Africa it decreased at an annual average rate of 0.80 percent, 2.00 percent and 1.71 percent, respectively. In the 1990s, only a few countries in the region recorded increases in the productivity of their set of productive factors - notably Chile, Argentina and Uruguay, which are among Latin America and the Caribbean most developed countries. In contrast, productivity in the poorest countries fell, in some cases substantially.
- In the international rankings of competitiveness, such as the *Global Competitiveness Report (GCR)*, the countries of the region occupy very low positions for their income levels, which suggests the presence of constraints on high growth rates. Only Chile, which occupies position 20 out of the 80 countries analyzed in GCR 2002, has an outstanding position in relation to its income level.

The causes for the lack of competitiveness of the countries of the Region are very diverse. At an aggregate level, the key factors are related to the macroeconomic environment, financial and capital markets, human capital, infrastructure and the quality of institutions:

- The severe macroeconomic instability of Latin American and the Caribbean is

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

revealed in the high volatility of economic growth, real exchange rates, real interest rates and the domestic credit supply. The main channel of amplification of the instability is the pro-cyclical nature of fiscal and exchange policies in response to external and internal shocks to which the region's economies are exposed, due to the composition of their exports, dependence on resources from external financing, internal political instability and natural disasters, among others. The pro-cyclical nature of policies reflects the lack of maneuvering space for fiscal, financial and exchange rate policies when shocks occur, which compels governments to apply policies to reduce domestic demand through higher interest and exchange rates. Such measures may increase the cost of the external debt service and erode the quality of the portfolio held by the financial system. Macroeconomic instability affects competitiveness, because it increases uncertainty and risk, and narrows investment horizons. It may also reduce investment in the human capital of the poor and limit the supply of credit and the terms of domestic and external financing.

- Other obstacles to the competitiveness of companies in Latin America and the Caribbean are the low availability of financial resources and the limited access to credit, both for large- and medium-sized companies, as well as for small enterprises and independent producers. Access to forms of financing other than bank credit is limited. The bond and stock markets have only recently begun to develop in most countries of the region. These limitations on access to financial resources prevent the profitable exploitation of productive opportunities, which reduces the productivity and competitiveness of the countries of the region.
- With respect to human capital, education suffers from notable deficiencies. The average education of the labor force grew at an annual rate of 1.5 percent in the last decade, below the 1.9 percent increase in the 1980s and less than in most developing countries. The Latin American workforce has an average of less than six years of education. This low level is not due to lack of access to the primary levels of the education system, or to low coverage of university education. The deficiencies originate at the secondary and technical levels, due to repetition and dropout from the school system by young people. This lack of basic education is not compensated by the training system, which has not been designed for that purpose, and which also suffers in some countries from problems related to centralism and poor links with the dynamic productive sectors. The limited levels of education for the bulk of workers hinder the assimilation of new technologies and forms of organization, reduce labor mobility, and consequently limit productivity and competitiveness.
- Lack of access to adequate infrastructure is an obstacle to the development of productive activities and the growth of companies. Unreliable power supplies, long waiting lists for access to telephone services, distorted fees due to cross-subsidies, roads in bad conditions, and inefficient ports that increase transportation costs, are some of factors that affect competitiveness. Traditionally, these infrastructure services have been supplied by State-owned companies, which in some cases proved to be inefficient, either due to poor management, or because they had objectives that went beyond the provision of the service.
- The deficiencies in public institutions are possibly the main cause of the problems of competitiveness in Latin American and the Caribbean. The channels are multiple. The deficiencies in the judicial system increase the risks of breach of contract

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

and, thus, transaction costs. They also limit the financial system's capacity to support the development of new investments, given the eventuality that their rights may not be respected. Government inefficiency or an environment that fosters corruption can discourage foreign investment and technology transfer, and divert resources from productive activities towards rent-seeking activities. The absence of a stable and respected judicial and legal system can eliminate the incentives to assimilate new technologies that require long-term investments, either in infrastructure or in other sectors. The lack of coordination between the public and the private sector can lead to loss of market opportunities that would require joint efforts for investment, innovation or organization. The absence of institutions that offer social protection or settle distributional conflicts can obstruct or prevent investment in highly productive activities because of the impossibility of compensating the losers. As a result, the deficiencies in public institutions are reflected in trends in productivity, as documented empirically in the *Economic and Social Progress Report 2001, Competitiveness: Engine of Growth.*

Additionally, it should be recognized that the level of competitiveness is not homogeneous over the entire territory of a country, or in the different entrepreneurial segments. Thus the Bank's strategy has to take these differences into account:

- The competitiveness of the different territories of a country depends on the same factors as national competitiveness, that is, access to factors (such as financing, skilled human resources, and provision of infrastructure) and the performance of institutions. Due to the differences in these conditions, there are enormous gaps in competitiveness and the capacity to generate income between provinces or states within countries, which in turn is reflected in the distribution of poverty and migratory trends, which tend to accentuate these gaps. Regional inequality in competitiveness also has a socio-cultural dimension: indigenous peoples, despite having comparative advantages such as social capital (organization, cultural diversity and knowledge) and natural capital (territories, natural resources, biological diversity), among others, are among the social segments with least access to financial market and provision of infrastructure services. At the other extreme, the large cities concentrate the bulk of productive resources, which are attracted by the economies of scale and agglomeration, but suffer from serious diseconomies of congestion, which may limit their competitiveness and the possibility of offering dignified living conditions to their inhabitants.
- The entrepreneurial structure of the countries of the region is characterized by severe polarization. First, there are a small number of large national or multinational companies, with a certain dynamic of integration into international markets. Second, there is a large number of small enterprises and microenterprises (in many cases, part of the informal sector), and small rural producers, with serious productivity problems, which generate about three quarters of jobs but lack access to financial markets, skilled labor force, and technological resources that are vital for their competitiveness. Increasing the productivity of these workers and companies is critical for improving social equity and competitiveness.

The great challenges facing the competitiveness of the countries of the region need to be addressed within the framework of trade liberalization and international integration.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Latin American companies have to compete globally with the producers of goods and services from other regions in international markets, as well as in their own. Business strategies should include the improvement of their competitive position in the global context and consider the options of transition toward more knowledge-intensive productive activities. The indispensable requirements for this are a higher level of specialization, important advances in technological development and greater integration into global productive chains, which is not possible in small markets. International integration processes are therefore key factors in improving the competitiveness of companies.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



LESSONS LEARNED

Need for integrated approaches. The Bank's activity in areas directly related to competitiveness has been growing in recent years, including operations in a wide range of sectors: financial markets, small- and medium-sized enterprises, microenterprises, transportation and communications infrastructure; rural and urban development; tourism; science and technology; among others. However, this diversity of operations has not always been developed in an integrated manner, within a global approach towards competitiveness for each country, province or department, which has limited their effectiveness and dispersed efforts. From the achievements and limitations of the experience of the Bank and other institutions, it is possible to extract a series of lessons for identifying and designing new operations for the IDB Group.

Macroeconomic stability. The development of productivity and competitiveness requires a sound and stable macroeconomic environment, which includes the fiscal, financial and external sustainability of the economies. Although severe inflation and fiscal imbalances have been controlled in most of the countries of the region, it is necessary to persist in the efforts to improve the macroeconomic environment and the resistance of economies to persistent shocks, especially of external origin. A stable macroeconomic environment is crucial for expanding the horizon of domestic and foreign private investment, and for enabling the development of financial markets and infrastructure.

Adequate economic and institutional signals. The development of productivity and competitiveness requires a system of economic and institutional signals that give individuals and companies a guarantee that they can appropriate the income derived from their efforts of productive investment, innovation and work. If the system of incentives and institutions leads to rent-seeking behavior or stimulates inefficient production, rather than stimulating innovation and improvements in productivity, efforts to increase investment, education and access to productive resources will be ineffective.

In the past, Latin American countries attempted to promote the competitiveness of specific sectors or activities through differentiated taxes or tariffs or subsidized public service fees for certain groups of companies or individuals. In general, these attempts were unsuccessful, mainly due to the difficulty in isolating the influence of pressure groups and, in some cases, the manipulation of these incentives, but also because of the growing fiscal and administrative costs involved.

A good economic and institutional environment is obviously a necessary condition for improving the productivity of sectors, regions or specific groups of companies. But the most suitable instruments for confronting deficiencies in productivity are not tax or financial incentives or price distortions, but rather policies that make a direct contribution to improving the productive and technological capacities of individuals and companies, and which facilitate interaction between companies and create a favorable environment for concerted action by the private, public and

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

Box 1: Institutionality For Competitiveness: Lessons Learned In Concertation Processes

The development model based on an improvement in competitiveness requires a structure of dialogue and concertation between the public and private sectors. There are international experiences, as in most countries in the region, in which processes have been launched for debate and for the creation of an institutionality aimed at designing, executing and evaluating competitiveness policies and programs, from which some lessons may be obtained.

The institutionalization process. The conception of concertation as a dynamic process that is renewed and updated requires avoiding the idea that that the goal is limited to the creation of an organizational frame with a series of static functions. The value of this institutionality must be based on the process of discussion itself, the scope of a vision shared by the actors, proposals for action, the evaluation of the latter and the relaunching and updating of the debate.

- A *bottom-up process* implies the mobilization of businessmen, their organizations and civil society for the discussion of a shared conceptual framework.
- *Political independence* is essential for the continuity of the process. It is convenient to achieve the multi-party backing of the legislative as well as the executive branch of government.
- *Orientation towards action* is important for the process to become validated and thus avoid becoming rigid and letting the involved institutions become devalued.

Institutional organization for competitiveness lacks a pre-established formula: rather, it needs to adapt to each country's or region's geographical, historical, cultural and institutional conditions and stage of development. The manner in which different types of national, sub national or sector competitiveness commissions are organized depends on the level of institutional maturity at the outset and on the roles assigned to the actors involved

- *Government.* It concentrates on the creation of an appropriate macroeconomic, political, legal and social environment, in addition to working conditions for business, the establishment of the rules of the game and the efficiency of the institutions to enforce compliance with them.
- *Private-sector organizations.* They must be open to new partners (not be closed ground for interest groups), have an active role in the discussion of the restrictions on enterprise development, commit themselves to the development of a shared vision of the improvement of competitiveness, and invest in infrastructure and productive activities.
- *Educational and research institutions.* The professional training and the educational system, mainly universities and technological and research centers, is key for adapting human resources to the new competitive challenges, technology transfer, and for new entrepreneurs emergence.
- *Entities of civil society and the citizenry.* Civil organizations, foundations, labor unions and other types of institutions must be a reflection of what they represent in each country.

Among the ***risks to be avoided*** in the competitiveness concertation processes, one may mention:

- *Government control.* Occasionally it takes the initiative and, despite attempting to include the business and civil spheres as a whole, adopts a state control position on the process.
- *Predominance of interest groups.* The particular interests of economic groups may attempt to override the overall interest of competitiveness.
- *Implanting of foreign experiences.* It is a common occurrence to attempt to bring in competitiveness strategies and institutions without taking their lack of local roots into account.
- *Bias in priorities.* The choice of given clusters or activities in emerging sectors, or in sectors with high growth expectations, may marginalize other, equally important aspects, such as the development of less developed sectors or geographical areas.

academic sectors. Given that productive capacities depend on multiple factors, and may be inhibited due to very diverse reasons, any competitiveness strategy requires an integrated approach. (Box 1 presents lessons learned in consensus building processes for competitiveness).

Improvement in the supervision and legal framework of the financial system. Although

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

the region as a whole has made important progress in reaching and in some cases exceeding international standards in the area of financial regulation and supervision, there are several countries, especially the less economically developed, which are lagging with respect to their prudential practices. However, experience shows that the adoption of international regulatory practices is not in itself sufficient, since they can be ineffective when the rule of law is too weak to counteract the influence of individual interests or corrupt practices.

The rights of creditors are weakened in many Latin American and Caribbean countries by State interference in credit operations (caps on interest rates, loan amnesties or compulsory reprogramming that are harmful to creditors), limitations on the use and recovery of bank guarantees, and inadequate bankruptcy laws. All of these factors reduce the incentives of the financial system to grant loans, especially to small- and medium-sized enterprises and individual debtors. Another problem of the financial systems of some countries in the region is the excessively high level of public ownership of the financial sector, which usually results in inefficient allocation of loans, less competition and higher intermediation costs. Additionally, in some countries a series of regulations force the financial system to finance the public sector through the purchase of government bonds. These factors limit the possibility of efficiently managing the risks assumed by the financial system and are sources of vulnerability and instability.

Latin American and Caribbean capital markets also reflect shortcomings that are strongly linked to their legal and institutional frameworks. In particular, the property rights of investors need to be strengthened, especially those of small shareholders and institutional investors; as well as independent producers, micro entrepreneurs, and poor owners. It is also necessary to rebuild confidence in the mortgage markets, undermined in many countries by episodes of high inflation in recent decades, by government interference in credit conditions and by the lack of long-term savings instruments to finance loans. Insurance markets are another incipient segment of the capital market in most countries of the region. Their development is needed to improve the conditions of competitiveness in different sectors. A separate mention should be made of pension systems, which several countries have reformed, partly with the intention of strengthening capital markets (this issue is discussed in the Social Development Strategy).

Access by microenterprises to credit is still limited and only a small percentage of micro entrepreneurs have access to sources of external financing, and these are informal in most cases. The creation of systems of sustainable financial intermediation for microenterprises has to be based on the strengthening of micro financial institutions, which can be done through a variety of approaches. First, by the gradual professionalization, modernization and formalization of the micro financial institutions outside the formal financial system. To do this, it is necessary to develop specific regulations for this sector and for the credit cooperatives sector. This regulatory activity should be accompanied by an effort by the Superintendencies of Banks to supervise the formalized and regulated micro financial institutions. The fact that the sustainability of micro financial institutions is increasingly associated with their capacity to attract savings from their own market segment strengthens the need for regulation and supervision, which will contribute to increasing financial depth. Second, as the micro financial institutions become profitable, they will receive more attention from the formal commercial banks. The development of specialized techniques of risk valuation will be very important for increasing the banks' micro finance portfolio, which they should introduce if they genuinely wish to enter this market segment. The enhancement of proper-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ty rights for micro entrepreneurs, independent producers and poor owners, mentioned previously, may also contribute to improve credit access for those groups.

Strengthening reforms in the infrastructure provision sectors. During the last decade, most countries made sweeping reforms in an effort to link the private sector to the provision of public services and investment in infrastructure, and to limit the role of the State to defining policies and regulation. When it has been possible, competition has been introduced to improve efficiency; when this has not been possible, this responsibility has been left to regulation. Additionally, countries have sought to grant independence to regulatory agencies in order to protect investors and consumers from rent-seeking or opportunistic behavior by companies, government or political interests. To strengthen financial sustainability, fees for public services have been set at levels compatible with long-term costs, limiting fiscal subsidies to transparent transfers to small segments of poor consumers. However, after a decade of reform, and despite important achievements in sectors such as communications and to a lesser extent electricity, many countries are having difficulties in consolidating their reforms. This is due not only to international financial constraints and the macroeconomic situation in some countries, but also to institutional, technical and political problems in the design and implementation of the reforms.

Improvement of incentives for technological innovation. The adaptation and generation of technology and knowledge depends not only on human capital and the network of scientific and technological institutions, but also on the incentives available to individuals, institutions and companies, which enable them to benefit from the effort of innovation. Policies on property rights are especially important for countries of intermediate development, which have emerged from the initial stage of adoption of imported technologies and are now ready to move on to the stages of adaptation and later creation of new technologies.

Improvement of regulations and tax provisions for productive activity. One in three companies in Latin America and the Caribbean consider excess taxes and regulations as a serious obstacle to their development, and one in six see them as the most important obstacle. Tax, administrative, and regulatory complexity affect companies of all sizes, but the problem is more serious for small and medium-sized companies, which have fewer human and administrative resources. Following a global tendency, the countries with lower income levels in the region frequently impose more restrictions and bureaucratic requirements on setting up and operating companies than the more developed countries. The implicit cost of these requirements is proportionally very high for the productive potential and income of small enterprises in these countries. An excessive number of bureaucratic restrictions and requirements have been put in place to protect worker and consumer rights, enforce tax obligations and a wide range of sector, national and municipal rules and regulations. In practice, however, they usually lead to corruption and informality.

The legal framework for productive activities in the countries of the Region gives preference to protecting the side that is assumed to be the weakest in market relations: workers versus companies, consumers versus producers, debtors versus creditors, and, in the past, domestic versus foreign companies. These legal biases have rarely resulted in effective protection for the set of companies or individuals they are designed to defend. In practice they have contributed more to economic duality, where only a segment of workers, consumers or debtors benefit from the regulations, while the rest are excluded from formal economic relations, with adverse implications on their productivity and on their capacity to escape poverty. Clearly, the solution is not to

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ignore the rights of workers, consumers and debtors, but to balance them with the rights of employers, producers and creditors, and adopt effective mechanisms based on the system of incentives.

Improvement of effectiveness of labor protection systems. Although its declared purpose is to protect workers, labor legislation in many countries has not achieved this objective because it leads to the exclusion of large segments of workers from the benefits of formal employment. Given that there are no markets that cover workers for risks derived from industrial accidents, loss of job, disability, retirement or death, government intervention is required to protect them. However, the political discretion and the lack of economic criteria with which social security systems have operated have provoked, in many cases, their virtual bankruptcy, low coverage of the population, and significant distortions in the labor market. In recent years, the reforms of social security systems have focused on pension systems. However, important deficiencies persist in areas such as protection from the risks of dismissal, setting minimum wages and other compulsory legal benefits. The suitability of the existing systems should be evaluated on the basis of level of coverage, the ratio between employee benefits versus contributions imposed by the system, and the existence of other less distorting alternatives at similar costs.

Improvement of the institutional capacity of regulatory agencies. The effectiveness of legal and regulatory systems is critically dependent on the capacity of individuals and organizations and on mechanisms of public control to make them respected and enforced. Issuing regulations is not sufficient, however well designed they may be, if the government fails to take into account the institutional environment in which they will be implemented. This implies, moreover, that there is no ideal normative or regulatory framework that can be applied equally to all countries to improve competitiveness, only general guidelines which have to be developed and adapted to each case.

In particular, in the last decade the option to create legally independent bodies to regulate privatized sectors, tax collection and conduct monetary policy has gained popularity. The degree of success of these bodies has varied, leaving the lesson that mere formal or legal independence is insufficient. For independence to be effective, these bodies need political and social institutions that foster the operation of systems of control and supervision. If governments are not constrained by political mechanisms and public supervision practices that effectively prevent them from interfering in the decisions of these bodies, independence can never be more than a formality. Independence is not an end in itself, but rather an instrument to contain opportunistic and rent-seeking behavior.

Competition in the markets for goods and services is possibly the factor that most influences productivity. Public and private monopolies, cartels and vertically integrated companies are common in many sectors of Latin American countries. The purpose of the competition regulation agencies, only recently created in many countries, is to prevent abuse of dominant market position by monopolies, cartels or integrated companies. However, their effectiveness is limited by low levels of experience, by constraints on budgetary and human resources, and by lack of complementary institutions, such as adequate information systems to facilitate case studies, or independent, knowledgeable and expeditious judicial systems that help to enforce decisions. Given that the tasks of these agencies exceeds their capabilities, they need to concentrate on a few problem areas where they can be effective, such as cartels or exclusive distribution agreements in consumer product markets. To perform their functions, the competition regulation bodies need legal powers to enable them to demand informa-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

tion from companies under scrutiny and to take decisions that are enforceable without judicial action. These powers must be adequately controlled, allowing for example appeals in important cases, publicizing all decisions and establishing the case-law record of past decisions. To grant greater independence from the government and the judicial system, it is desirable that Congress appoints the regulator, and that the agency has administrative and budgetary independence.

Taking advantage of the opportunities offered by international trade. International trade is a fundamental source of competition in the goods markets. As the Regional Integration Strategy establishes, although in principle foreign trade is a form of competition that is easy to create and maintain, it sometimes requires support from the public institutions that record and oversee transactions, collect taxes, administer international integration agreements and regulate exports and imports.

Integrate the private sector into the design of programs to increase competitiveness. The failure of supply policies, in which governments selected the sectors that should receive support, and in which frequently there was a poor utilization of public resources, led to rethinking the role of the public sector in competitiveness policies. These policies now require the participation of the private sector in the design of productive development programs, and emphasize programs based on effective demand from companies, rather than on discretionary decisions by governments or their suppliers. Similarly, important operational lessons can be extracted with respect to the mechanisms of execution and delivery for all types of "active policies, in which execution of programs by private agencies, or through private wholesale entities, has been much more effective than the execution by public bodies. The efficient execution of programs by private agencies and the supervisory capacity required in these cases by the public sector is another important lesson learned in recent years. The lessons learned in the field of the evaluation of programs and policies are especially important. Any investment of public funds in productive development has necessarily to prove its effectiveness through measurement of results, reflected in the mobilization of private funds, generation of additional income, return on investment (including the public sector) and improvement in the competitiveness conditions of companies.

In particular, the private sector has to be included in the design of programs to improve the productivity of micro- and small enterprises. Some lessons can be derived from the evaluation document of the Bank's actions and strategy for Small- and Medium-Sized Enterprises (RE–273), prepared by the Office of Evaluation and Oversight (OVE). It is worth mentioning the need to include the private sector in the design of programs to find innovative formulas for intervention, which can confirm the diagnosis of the sector and demonstrate the importance of the proposed actions. It is also necessary to include in the Bank's diagnosis of the conditions of competitiveness in the various countries, the problems of the SMEs, including an analysis of their market segments, their dynamic and the main challenges to improving their competitiveness and productivity. Finally the sector requires instruments that strengthen its strategic capacities in the management of new business, introduce information technologies, facilitate adaptation and development of innovation, support access to new markets, stimulate business alliances, develop new financial vehicles linked to the capital market, and promote the development of entrepreneurial capacities.

The need to take environmental aspects into account in efforts to improve competitiveness. From the point of view of the environment and the management of natural capital, the lessons show that an efficient and credible

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

normative and regulatory institutional framework is fundamental for facilitating public and private investment. Although such a framework is present in practically all of the countries of Latin America and the Caribbean, its capacities are considered to be weak; the weakest areas being perhaps monitoring and inspection. Another lesson has been that, at the core of environmental problems, is the lack of effective incentives for environmental protection and management of natural resources, which is a critical aspect for competitiveness because the systematic deterioration of natural capital eventually puts a brake on productivity. This leads to the conclusion that the application of economic instruments that give the right signals for appropriate environmental behavior is essential. These instruments have to be accompanied by institutional actions to facilitate their application, such as property and user rights, registries and inventories of use, as well as open information on the supply and demand of environmental goods and services.

The lessons also show that the environment can be a good business in which private initiative and private investment can contribute to its quality and value-added. The role of the private sector has been shown to be fundamental and effective in areas such as: environmental markets associated with agricultural production; markets for environmental services associated with forest development, biodiversity, renewable energy and eco-tourism; concessions for private management of environmental components (protected areas, sewage treatment); and investment in industrial decontamination, waste handling and clean production processes. As part of the environmental management process, it is important to strengthen these positive aspects of private enterprise, including actions to generate capacities at the level of associations, chambers of commerce and other actors, which can make environmental management more effective from the private point of view.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

AREAS FOR BANK ACTION



Based on the previous diagnosis and lessons learned, this section presents the Bank's priority action areas, which are aimed at: (A) efficient mobilization of financial and capital resources; (B) improvement and higher productivity of human resources; (C) efficient provision of infrastructure services; (D) development and assimilation of new knowledge and technologies; (E) more effective support institutions for private productive activities; and (F) competitiveness and the productive and sustainable management of natural capital. The actions focus on alleviating market failures of the main productive resources, in the areas in which the Bank has a comparative advantage and the capacity to influence national policies. The Bank's actions, in coordination with MIF and IIC, will also seek to ensure that factor markets develop in a way that makes them more accessible to different regional areas, and to the majority of companies in each country, irrespective of their size.

In addition to the specific actions described below to raise the countries' competitiveness, strong macroeconomic fundamentals and conditions of economic stability are needed as a prerequisite to increase productivity. A sound macroeconomic environment includes fiscal, financial and external sustainability of the economy. As mentioned in the Strategies for Sustainable Economic Growth and Modernization of the State, and given the particular functions and comparative advantages of other international organizations, the priorities of the Bank's action in this area will be: strengthening tax systems and their administration; improving budgetary institutions and fiscal management; strengthening sub national fiscal institutions; and giving access to financial resources during temporary external imbalances.

CAPITAL AND FINANCIAL RESOURCES

To promote policies and institutions leading to the mobilization and efficient utilization of financial and capital resources, and given the Bank's experience, it is recommendable that it concentrate on supporting countries in: (a) strengthening the legal and institutional framework in which financial systems operate; (b) developing financial regulatory agencies; (c) strengthening capital markets; (d) strengthening property rights over assets (particularly of the poor), such as land and housing; and (e) developing micro finance systems and other alternative institutions to expand access to credit.

a) *Strengthening the legal and institutional framework in which the financial systems operate.* The depth of the financial system is fundamental for stimulating competitiveness and growth. Consequently, the basic quantitative criterion to be used to determine the Bank's priority actions in this area will be the ratio of private sector credit to GDP. In most countries of the region, this ratio is very low in comparison with international standards, given the income level of the countries. Many different factors can limit the depth of the financial system. Particularly important are the Rule of Law and the effective operation of the judicial system, issues that are discussed in the Modernization of the State Strategy. This Competitiveness Strategy will focus especially

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

on the institutional and regulatory barriers that most directly inhibit the development of the financial system. Particular attention will be paid to the effective protection of creditors' rights, that is the capacity of creditors and debtors to enter into contractual agreements with independence of the contracting parties, coverage of the risk of default and certainty of enforcement of the agreed terms. The Bank will help governments to set up regulatory and institutional systems that guarantee the rights of creditors and enable the private sector to manage its risks efficiently. The Bank will help countries to limit the role of State-owned banks to the provision of support services for the private segment of the system in activities that the private sector cannot provide on market conditions.

b) *Development of the financial regulation institutions.* Strengthening financial regulation and supervision is fundamental to guarantee the stability of the financial system. The authorities in each country must promote a stable macroeconomic framework and a set of rules and mechanisms to enforce them, which enable an adequate management of the risks assumed by the financial system, thus protecting the integrity of deposits. International standards in this area are evolving rapidly and the authorities must make efforts to keep abreast of developments. It is also important to bear in mind that not all international agreements are applicable to all the countries at all times. The recently proposed changes to the Basle agreement, for example, require internal systems of risk evaluation which several countries do not have and which take time to develop. The Bank will assist countries to adapt their regulation and supervisory systems to international standards, based on the priorities and possibilities of efficient operation of these standards in the conditions of each country.

c) *Strengthening of capital markets.* The capital markets of Latin America and the Caribbean also have deficiencies that are closely linked to the legal and institutional frameworks. In particular it is necessary to strengthen the property rights of investors, especially small shareholders and institutional investors. It is also necessary to rebuild confidence in mortgage markets, undermined in many countries by episodes of high inflation in recent decades, by government interference in credit conditions and by lack of long-term saving instruments to finance credits. Insurance markets are another incipient segment of the capital market in most countries in the region whose development is necessary to improve the conditions of competitiveness in different sectors. Separate mention should be made of the pension systems that have been reformed in several countries in part to strengthen capital markets (this topic is discussed in the Social Development Strategy). The IDB will support countries in modernizing legislation and institutions with a view to creating incentives for development of capital markets. However, especially in small countries, this will not be sufficient to guarantee the efficient development of these markets. In the small economies, the development of capital markets (and even the financial system) has to assume a regional dimension. Consequently, the Bank will assist countries to produce uniform standards, practices and regulations, to facilitate the international integration of stock markets, especially among the small countries. The Bank will also support efforts at macroeconomic coordination among the countries of the region, in order to moderate fluctuations in financial conditions and capital markets, especially between the members of trade agreements, as indicated in the Regional Integration Strategy.

d) *Improvement in the property rights of assets (particularly for the poor) such as land and housing.* Access to credit for the poorest sectors of the population is hindered in many Latin American and Caribbean countries by

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

deficiencies in the systems of property registration and guarantees. Millions of informal and rural workers own properties that could be used to guarantee access to credit if their property titles were legally clear and the guarantee registries unified. The Bank will assist countries to improve their property and guarantee registration systems. In rural areas, the Bank will also promote access to the land by poor producers through low-cost mechanisms, such as leasing markets and shared financing. These actions will receive attention in countries where wide differentials have been detected in income and productivity between workers in the formal and informal sectors (including small farmers), or where there is direct evidence of lack of access to credit for specific groups of producers (such as indigenous communities).

e) *Development of micro finance systems and other alternative institutions for expanding access to credit.* The access by microenterprises to credit is still enormously limited, and only a small percentage of microentrepreneurs has external sources of finance, which in most cases is of an informal nature. The creation of sustainable financial intermediation systems for microenterprises has to be based on the strengthening of micro finance institutions, which can be done through different approaches. On the one hand, through the gradual professionalization, modernization and formalization of the micro financial institutions that are currently placed outside the formal financial system. In order for this to be possible, it will be necessary to develop a specific regulation for the sector, as well as for the credit union sector. These regulatory activities must be accompanied by a complementary effort by the Superintendencies of Banks, to supervise the formalized and regulated micro finance institutions. The fact that the sustainability of micro finance institutions is increasingly associated with their capacity to attract savings from their own market segment strengthens the need for their regulation and supervision, which will contribute to increasing financial depth. On the other hand, to the extent that micro finance reveals itself as a profitable activity, it will receive greater attention from the formal commercial banks. To facilitate this process of increasing the micro credit portfolio of the banks, it will be very important to develop specialized techniques for risk valuation, which banks will need to incorporate if they genuinely wish to enter this market segment. Additionally, the rapid growth of the micro finance activity must find its own source of finance. In this sense, it will be critical to create the conditions that favor the investment of private capitals in micro financial institutions, for which the conditions of accounting transparency and solvency are vital. Finally, it is necessary to mention the conditions of the regulatory environment and the operation of institutions (from property rights to guarantees over assets), which are further developed in other sections of this document. The Bank will support the Superintendencies of Banks to strengthen their professional capacity to regulate and supervise the micro finance institutions, and will continue to strengthen the micro finance institutions, not only in the credit activities, but also in attracting savings and the development of other financial products. In this sense, it will support the capacity of the base organizations to administer their loan portfolio, favor growth and *upgrading* of the micro finance institutions so that they can become regulated entities, and will facilitate the *downscaling* of the commercial banks that are interested in serving the micro enterprise market segment. Likewise, the Bank will support the quality and availability of information on the micro finance institutions and their risk analysis, in order to favor the attraction of private capital for their financing.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

HUMAN RESOURCES: LABOR TRAINING, LEGISLATION AND INTERMEDIATION

The Bank will promote policies and institutions to develop human capital and raise the efficiency of human resources. The Bank's long tradition in assisting educational sectors has created a valuable experience. The Social Development Strategy includes a series of policies aimed at reforming the educational sectors and improving human capital in order to, among other things, reduce dropout rates, adapt education to provide basic skills, and facilitate the transition from school to work. The Competitiveness Strategy emphasizes specific aspects related to the labor market, placing emphasis on competitiveness and productivity. To improve productivity in this field, the Bank will give priority to the following areas: (a) reform of labor training systems to introduce competition, promote the participation of the private sector and enhance the relevance of training; (b) mechanisms for training entrepreneurs and workers, in order to strengthen micro-, small- and medium-sized enterprises, and improve their productivity and trading opportunities; (c) modernization of labor and collective bargaining legislation with a view to facilitating the hiring of labor in the formal sectors, reducing the labor costs due to unnecessary legislation, facilitating relations between employers and workers and improving the conditions for worker protection; and (d) strengthening systems of labor intermediation to facilitate job seeking and identification of employment opportunities.

a) *Reform of training systems.* A skilled workforce is crucial if companies are to improve their competitiveness. Training must receive priority in countries in which the level of education of the labor force is low, relative to the country's development and income level, or where the indicators of employers' opinions on the quality of the workforce are very unfavorable, relative to the country's level of development. To improve worker skills, almost all countries will have to make sweeping reforms of public training institutes, traditionally based on a model where training is considered to be a public good which the private sector would not produce for itself, and which has to be financed by a payroll tax. The general perception in the region is that this scheme of organization generates a type of training that, with some exceptions, is not up-to-date or relevant to companies' needs. Thus, the Bank will promote the reform and reorientation of the public and private training institutions, so that private sector demand defines the provision of training, and that more of it takes place on site, in the workplace, rather than in the classroom. The public sector will move away from its role as a provider of training, and towards a role as regulator of the training provided by the private sector. A successful strategy for reforming the training system requires the support of education, tax and labor policies, which go beyond reform of the public training institutes. For its part, tax policy can play a crucial role in facilitating the acquisition of skills by workers. As a minimum, investment in training should receive the same tax treatment as investment in physical capital. The Bank will assist countries in the region to implement transparent tax schemes, adapted to each country's conditions, which contribute to improving the incentives for private training. In the area of labor policy, several fronts should be taken into account. The regulation of the labor market should permit innovative forms of hiring, in which employers and workers decide how to generate high quality training and how to share the costs of the training. The inclusion of training clauses in collective agreements could be such an instrument. Additionally, the mechanisms of temporary income protection for unemployed workers should include options beyond mere monetary transfers. The objective should be rapid and adequate reintegration into the

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

labor market. In this respect, the Bank will support the development of intermediation services (see below) and retraining for unemployed workers, which responds to specific market demands.

b) *Promote training for employers and workers of micro, small and medium enterprises.* The micro, small and medium-sized enterprises, as well as small rural producers, account for nearly three fourths of employment, and employ the bulk of the poorest workers in the countries of the Region. These enterprises and producers have severe productivity problems, and they confront constraints to access training programs, due to their small size and lack of administrative sophistication. Increasing the productivity of these workers and improving the competitiveness of these enterprises will be critical to improving social equity and competitiveness. As a criterion to analyze the priority that should be assigned to this area, the income or productivity gaps between similar workers in the large and small enterprises will be used. The Bank will assist countries with the design of training programs especially adapted to the conditions of micro, small and medium-sized enterprises, as well as small rural producers, since traditional training systems do not usually reach these groups. A possible modality is to go through private producer chambers and other associations that are closely involved and have empathy with the problems of small producers. To support these initiatives, the Bank recognizes that the probabilities of success are higher when the program starts by identifying groups of companies or producers with similar characteristics and needs based on location or the nature of their production, and when technical support is offered to assist the companies to identify better ways to organize and market their production, and consequently identify the training needs of their workers. A public policy objective to promote the first stages of worker training for small enterprises or producers will be to demonstrate its profitability through improvements in productivity, and consequently gradually generate a market for training services. The experience with the use of training bond programs is one of the mechanisms to generate the market from these services from the demand side. Additionally, the Bank will promote financing mechanisms to train young, low-income workers, who may not be able to access the training systems due to imperfections in the credit markets.

c) *Modernize labor legislation and policies.* Labor legislation in Latin America and the Caribbean is intended to protect workers in the employment relationship, rather than facilitate the operation of the labor market. In those countries where the rates of informality are higher and the employment rates of the population of working age are lower, relative to international benchmarks, the modernization of labor legislation must be considered a priority in the Bank's activities. However, the Bank will take into account that all labor legislation must reflect a social accord, and that any reform should be the result of broad social dialogue and consultation. In order for the labor market regulation to contribute to job creation and competitiveness, its main objective must be to correct market failures, which should be differentiated from the objective of protecting workers. To achieve the first objective, labor legislation must promote the free and rapid creation of jobs, prevent discrimination, and restrict employer collusion. In many countries, the existing legislation works against competitiveness, among other reasons because it discourages or prevents temporary or flexible employment contracts, limits payments based on productivity and hinders dismissals, even when businesses have economic problems.

Apart from facilitating the creation of jobs and protecting the worker, labor institutions should facilitate labor relations between employers and workers. The legacy of a culture that sees these relations as a game of los-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ers and winners, along with the predominance of asymmetric information in the labor market, are sources of conflict that need more channels for resolution. This situation results in industrial relations marked by lack of cooperation, which has negative consequences on labor productivity. The Bank will assist countries in establishing spaces for dialogue and negotiation, and mechanisms and institutions for conflict prevention and settlement, to facilitate the development of more cooperative labor relations.

d) *Strengthening labor intermediation systems.* To increase the productivity of workers and firms, it is necessary to have fluid channels of information that help companies and workers to identify opportunities for the best use of human resources. Thus, the Bank will assist countries to set up intermediation systems to facilitate the process both job search and hiring of employees. It will also assist in creating incentives for the incorporation of mechanisms for the identification of job identification within training systems.

INFRASTRUCTURE SERVICES

The Bank will promote policies and institutions for the provision of infrastructure services, including energy, telecommunications, transportation, water and sanitation. The Bank, which has played a leading role in the privatization and modernization processes in the infrastructure sectors, should now concentrate on the following activities to assist countries to consolidate the progress achieved, and complete the reforms needed to reach the original objectives: (a) adaptation of regulatory and legal frameworks, and strengthening of the regulatory and market institutions involved in the provision of infrastructure; (b) financing of infrastructure investments, including the design and implementation of new modalities of access to domestic and international capital markets and expansion of coverage to underprivileged segments; and (c) support for the processes of restructuring and sale of state-owned companies.

The consolidation of the reforms in the infrastructure sectors requires the support of institutions that are indispensable for the smooth operation of markets, such as the rule of law, an efficient judicial system, strong property rights, and mechanisms to control monopolies and prevent and cover the main systemic risks. These topics are discussed in the Modernization of the State Strategy.

a) *Adaptation of regulatory and legal frameworks, and strengthening of regulatory and market bodies for the provision of infrastructure.* The success for the option of incorporating the private sector in the provision of infrastructure is critically dependent on the regulatory frameworks set up to stimulate competition, raise efficiency and enhance the quality and coverage of services, without neglecting the needs of remote and low-income sectors. The Bank will continue to assist countries to develop and adapt regulatory frameworks and strengthen the regulatory, policy-making and public contracting bodies indispensable for achieving these objectives. There is no single formula for the regulation or supervision of private activity that is valid for all the infrastructure sectors, much less for the different countries. However, there are some elements that can contribute to the success of the regulation, which the Bank will promote. First, strengthening the credibility and technical competence of regulatory bodies, by identifying and removing barriers of different types, which have hindered its operation in the past. The Bank will take special note that the regulatory frameworks and modalities that each country chooses are in line with the technical and institutional capacity of the regulatory agency. Experience has shown that regulatory frameworks that are excessively complex for the capacity of the agency facilitate their capture

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

and reduce their credibility. Second, the Bank will support the countries in establishing public oversight mechanisms to review the operations of the regulating agencies, in order to protect the users, suppliers and the government, without interfering in the independence of the regulatory bodies. For this purpose, it will support the adoption of mechanisms to enhance accountability and to strengthen auditing and judicial systems to accomplish this oversight role. Third, the Bank will support the strengthening of State capacity for policy definition, planning and public contracting. In separate documents, the Bank will define in greater detail the support and regulation strategies for each infrastructure sector.

b) *Financing of investments in infrastructure, including the design and implementation of new modalities of access to domestic and international capital markets.* Access to financing is one of the main barriers that Latin American and Caribbean countries face in developing their infrastructure. In the past, these investments were financed primarily with public funds, but the fiscal constraints and the rapid technological change in these sectors have imposed the need to bring in private capital. The Bank has to act as a catalyst for private participation in the financing of infrastructure, which can be discouraged by high market risks and political risks, which affect the conditions of participation and ownership of investments. Although private agents are more qualified than the government or international organizations to evaluate and mitigate market risks, they can require protection mechanisms against political risks. The loans or guarantees that the Bank may offer should seek to help mitigate the political risks, without destroying private incentives for evaluating market risks (demand and cost risks). The Bank should also contribute to reducing the political risks by promoting sector reforms and regulations. In addition, the Bank will support the development of financial instruments to facilitate the financing of these investments. For example, it will support the development of long-term and local currency instruments. The growing importance of pension funds in the region opens a window for financing investments in infrastructure; however, the financial instruments to enable this have to be developed.

c) *Expansion of coverage to underprivileged segments.* The productivity of the poor depends on access to infrastructure services, including electricity, water, communications and transportation. The Bank will support specific actions aimed at promoting public and private investment in infrastructure for the poor and excluded, especially in rural areas, where infrastructure deficiencies are more significant. The Bank will promote programs to provide low-income groups access to basic services (particularly electricity and water) in conditions of environmental and economic sustainability; the Bank will assist with the adoption of appropriate technologies for power generation and telecommunications in rural areas where conventional technologies may not be efficient; and will promote local management of basic infrastructure and transportation systems, taking into account local cultural conditions, especially in ethnic areas. When the delivery of a public service has been privatized, the Bank will also take into account the need to create incentives to extend the services to remote regions and low-income groups. The Bank will support mechanisms that facilitate expansion of coverage through explicit subsidies for network and connection expansion, but will not support hidden subsidies. Cross-subsidies between market segments will be acceptable, provided that they are adequately designed and prove to be the most efficient option for achieving the objectives.

d) *Support for restructuring and sale of state-owned companies.* The Bank will continue to support re-structuring and privatization

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

processes of state-owned companies, incorporating the lessons learned, where the economic and institutional conditions of countries provide an adequate basis on which the reformed sectors can improve the efficiency, coverage and quality of services in environmentally, financially and physically sustainable conditions. These processes will take into account the need to foster access to the low-income and rural areas, as stated in the previous paragraph.

DEVELOPMENT AND ASSIMILATION OF NEW TECHNOLOGIES

Policies and institutions for the development and assimilation of knowledge and new productive technologies are an essential area for competitiveness, in which the Bank can assume a leadership role to strengthen the development of innovation systems in the region. This area should receive priority, when the indicators of efforts and results in science and technology (such as total spending on research and development, participation of the private sector in research and development spending, the number of researchers and publications, or the number of patents) are low relative to the level of development of the country. Science and technology policies, especially the definition of priorities between basic and applied research and the dissemination of technology, must respond to the institutional and productive characteristics of each country. Consistent with the Science and Technology Strategy, actions should concentrate on (a) diagnosis of the innovation systems; (b) strengthening institutions that generate science and technology; (c) strengthening intellectual property rights; and (b) speeding up technological improvement in small enterprises and poor producers.

a) *Diagnosis of innovation systems.* In order to be effective, an innovation system requires a fluid interaction between its components, including universities and research institutes; technological institutes; technology, communication and information services companies; companies that produce goods and services; and the government and institutions that regulate relations between these agents. The Bank should promote evaluations of national innovation systems, to identify their strengths and weaknesses and forms of interaction. These evaluations should take into account the economic and institutional environments in which the processes of generation, dissemination and utilization of technology take place, including the ease in setting up companies, development of cooperation agreements on innovation, respect for intellectual property rights, operation of patent systems, and national and international regulatory frameworks in the area of technology transfers and service trade.

b) *Strengthening the institutions that generate science and technology.* The Bank will support integrated programs to strengthen the organizations that generate science and technology and the institutional system in which they operate. In these efforts, special attention should be paid to the technological institutes, which were originally set up in many countries to produce applied research but which have frequently failed to develop relations with the productive sector for the development of useful applications to increase productivity. Dependence on public sector budgets and lack of incentives to forge closer links with productive sectors have limited the effectiveness of these institutes. The same applies, to a large extent, to the public universities, which often have not succeeded in operating as a central element of the science and technology system, which should be their function. The Bank's experience and capacity for developing projects and programs of institutional reform are a very valuable asset for working in these areas.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

c) *Strengthening intellectual property rights.* The Bank will support the development of systems for protection of intellectual property and patents, as part of broader programs of local technological development, including the promotion of innovative mechanisms for protection and promotion of traditional knowledge. Additionally, support for the institutes and agencies that administer patent systems can generate information mechanisms for spreading technologies that are already in the public domain.

d) *Speed up the technological improvement of small-, medium- and microenterprises, and independent producers.* The rate of assimilation of the new information technologies in most Latin American and Caribbean countries has been more rapid than might have been expected for their income levels. The factors that explain this initial dynamism are the opening of the countries to trade and foreign investment, the high level of education of employers and employees of large companies, and the modernization of the telecommunications sectors in many countries. But these factors of initial success do not guarantee an equally rapid dissemination towards smaller enterprises. This will depend to a large extent on the ease with which new formal companies can be set up, on access by small- and microenterprises to information and sources of capital and financing, and on the response capacity of training systems to the new demands for technological education. These issues are dealt with in other sections of this Competitiveness Strategy. Additionally, in the countries where these basic conditions of success exist, the Bank can contribute to maintaining the rate of penetration of the new technologies with the aim of reaching small enterprises and producers, through programs that facilitate access to information technology and technical assistance; stimulate the cooperation on research and development between companies, and between companies and technical institutions; develop and disseminate technical standards for products, processes and quality standards; strengthen the ability to identify, generate and adopt appropriate technological innovations to environmentally sustainable rural economic activities; expand the Internet infrastructure through telephone cabins, rural telecenters, community information centers, or centers accessible to small enterprises; and promote the training of poor workers, micro entrepreneurs and small rural producers in the use of these technologies, including their incorporation into the school curricula. The Bank may also support pilot programs or creative experimental efforts, which seek to develop new technological applications, particularly in information technology.

COOPERATION FOR COMPETITIVENESS

The Bank will promote effective institutions that support the functioning of private productive activities. The modernization of different aspects of the public administration can contribute to improving competitiveness in the countries of the region. The Modernization of the State Strategy includes a series of actions related to the transparency and effectiveness of the agencies involved in regulating economic activity, protecting consumer rights and other areas related to the participation of civil society in overseeing the economic decisions and activities of government and the private sector. This strategy, consistent with the Modernization of the State Strategy, is concerned with the strengthening or development of institutions directly related to competitiveness in the fields of: (a) cooperation between the public and private sectors to improve competitiveness; and (b) promotion of corporate social responsibility.

a) *Facilitate cooperation between public and private sectors to improve competitiveness.* To improve the climate for private productive activities, the Bank can act as a catalyst and

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

support the processes of dialogue and cooperation between the public and private sectors (including entrepreneurs, workers, academics), which lead to consensus-based strategies and action plans to improve competitiveness at the national, regional or sector level, and to move forward with legal and institutional reform processes in order to facilitate the establishment of new companies, technological improvement and increases in productivity. This activity includes support for clusters and the strengthening of productive chains, through associative efforts between companies of different sizes or sectors, and between these and the academic and public sectors. Because of its importance for the productivity of the poor, the Bank will emphasize the associative capacity of small rural producers and promote local, integrated and participative programs, co-financed and preferably managed by the private sector, to provide business development services to microenterprises, emphasizing cooperative systems of production or distribution and the inclusion of microenterprises in programs to develop production networks and chains to exploit economies of scale, connect them to domestic and international markets, and achieve reductions in the costs of supplies, production and distribution. In order for this public-private dialogue to be effective, both parties need strong professional institutions. In many countries, it will be necessary to strengthen the capacities of the public sector to perform diagnoses, identify and debate the priorities with the representative entities of the private sector, jointly design specific programs, agree their execution with private entities and, above all, adequately supervise, follow-up and evaluate their results. Technical and professional public institutions are necessary to foster competitiveness.

b) *Promote corporate social responsibility.* Corporate Social Responsibility (CSR) is understood as the consideration and incorporation by corporations of a number of social and ethical factors and responsibilities, beyond their traditional line of business, within their corporate strategies and decision-making processes. These social and ethical considerations encompass a broad range of issues, from sustainability, the environment, labor relations, accountability and transparency, human rights, and community involvement. Corporations take into consideration a broader range of stakeholders, than just their shareholders and upper management, to include their employees, investors, suppliers, consumers, community organizations, and civil society organizations as a whole. CSR is perceived to be an important component of success and competitiveness of companies, in the highly competitive global markets, and may yield significant benefits to both the enterprise and its stakeholders. The IDB Group will promote CSR, as a means to increase private sector competitiveness in the Region, as well as to generate value for the enterprises.

COMPETITIVENESS AND SUSTAINABLE MANAGEMENT OF NATURAL CAPITAL

The Bank will promote the preservation and sustainable management of natural capital. Economic growth can affect natural capital through overexploitation of natural resources and increased pollution from productive processes. But economic growth can also be the vehicle for the generation of services and development of markets and institutions that favor the sustainable use of natural resources and upgrading of environmental conditions. Different actions link competitiveness, environment and the management of natural resources. The priority areas for Bank action in the environmental area that are fundamental for stimulating competitiveness are: (a) actions to preserve the productive value of natural resources through the development of eco tourism, financially sustainable management of protected areas, and

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

biodiversity protection, among others; (b) actions to promote the adoption of clean production processes and private participation in the development of new markets for environmental services through the certification and adoption of clean production processes and the promotion of private management of sanitation services, protected areas, eco tourism and forest concessions, among others; and (c) actions to capitalize on global and regional opportunities such as the Clean Development Mechanism (CDM) for reduction of greenhouse gas emissions through the financing of activities that fix carbon through biomass production projects; among others. These actions are described in more detail in the Environment Strategy.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



OPTIONS FOR BANK SERVICES

The Bank's instruments and services should make a coordinated contribution to the achievement of the objectives of sustainable economic growth, and poverty reduction and promotion of social equity. Competitiveness will be an integral and specific part of the processes of dialogue, broad consultation and programming in the countries. These processes will lead to the identification, based on a selective criterion, of the concerted actions of the IDB Group, taking into consideration the needs of the countries, the Group's comparative advantages, and the comparative effectiveness of all the possible interventions. By its very nature, any competitiveness strategy requires an integrated approach and joint implementation by the public and private sectors. The Bank can act as a catalyst and promoter, through its financial and nonfinancial instruments.

The IDB Group has a set of financial instruments for contributing to the improvement of competitiveness in the Region and, if new instruments are necessary, it has the capacity to create them. Traditionally, the Bank has supported programs with public sector bodies through investment loans, sector loans, technical cooperation operations (reimbursable and nonreimbursable) and, more recently, through emergency loans and flexible lending instruments. The Bank has also been developing different operating modalities with the private sector without government guarantee, including loans, guarantees, capital investment, and the Social Entrepreneurship Program. In programs that effectively support efforts to improve competitiveness, these aspects of activity should be complementary to an integrated and coherent approach within the IDB Group. The Private Sector Coordination Committee, in which all the entities of the IDB Group participate (Inter-American Development Bank, Inter-American Investment Corporation and the Multilateral Investment Fund) is instrumental for this purpose.

The IDB Group also has complementary nonfinancial services and technical assistance, including: support for diagnoses, and the design and implementation of national strategies; policy dialogue; seminars and conferences; research activity; and generation and dissemination of best practices and lessons learned.

This integration process implies that the actions in the area of competitiveness that the Bank supports in the borrowing member countries will be closely coordinated with the actions planned for the objectives of sustainable growth and poverty reduction, and the other priority areas of the Institutional Strategy, which will result in the formulation of integrated packages of activities and operations by country. The activities in the area of competitiveness will be defined in close coordination with other national, regional and multilateral development institutions, and with the private sector; seeking to exploit the synergies of complementary and coordinated interventions. For this purpose, the IDB Group will seek strategic alliances with institutions that bring together the interests of the public and private sectors and civil society, to facilitate and support the selection of programs that offer the highest degree of consensus and ownership.

To strengthen the effectiveness of the IDB Group's contribution in the area of competi-

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

tiveness, the Bank will identify the programming priorities and actions to enhance the design quality of the programs and their successful execution. At the country level, a Country Strategy will be formulated following the guidelines approved by the Board (GN–2020), with the analytical rigor and procedure recommended in that document, which sets up a framework for the implementation of key actions at the level of: programming; design; and execution of operations. In addition, activities for the support of these key actions in the areas of research, identification of good practices, and knowledge diffusion are specified. These guidelines propose a close coordination with the IIC and MIF. The Bank's Country Strategy will be coordinated with the government, and will take into account the activities of other regional and multilateral organizations, in order to coordinate the activities and exploit the comparative advantages of each institution.

As mentioned in the guidelines for the preparation of the Country Strategies, at the programming level, the IDB Group has used instruments of dialogue and other institutional actions to seek consensus, which have been effective when based on diagnoses and have facilitated coordination with other sources of financing.

If the sector diagnoses proposed in the Sustainable Economic Growth Strategy indicate that the lack of competitiveness is one of the most important constraints to achieve the objectives of growth and poverty reduction, and if national governments request it, the Bank will assist in the preparation of National Competitiveness Strategies, which some countries have already prepared, with the participation of different national sectors and actors.

Taking advantage of its capacity to promote and maintain a long-term agenda in the region, the Bank will emphasize the consolidation or creation of bodies of dialogue and negotiation between the public and private sectors (such as the National Competitiveness Councils, which have already been formed in 11 countries), whose purpose would be to identify priorities and strategies for competitiveness and business development. The work of these bodies will be used as an input into the programming process and into the selection of priority actions in the area of competitiveness in each borrower member country. The Bank will move ahead with the preparation of best practices for this type of institutional competitiveness framework.

Additionally, to encourage a more efficient use of its financial and nonfinancial products for development of private-sector competitiveness, the Bank will promote a better integration of its activities involving the private sector with the programming exercises in each country, with the active participation of the Private Sector Department (PRI), MIF and the IIC, in the tasks prior to programming, in the programming, and in missions to identify specific projects, always under the coordination of the Regional Departments.

An effective and integrated effort in the area of competitiveness, which formulates coordination and implementation mechanisms, requires an appreciation of the timing and sequence of the actions and the use of appropriate instruments in all phases of the competitiveness programs supported by the IDB Group. These programs can include four phases: diagnosis, institutionalization, implementation and impact evaluation.

Diagnosis: Given the broad range of issues related to competitiveness, the Bank's interventions should be based on diagnosis of the barriers that prevent the strengthening of competitive advantages and acceleration of the process of sustainable and equitable development. As a result, the IDB Group, in coordination with other regional and multilateral organizations, as proposed in the framework strategy of Sustainable Economic Growth, will carry out sector diagnoses, in

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

order to identify the internal barriers and restrictions that cause the high production and transaction costs, lack of information, low levels of productivity, and obstacles to the efficient operation of markets. These diagnoses, coordinated by the Regional Departments, will be based on sector studies (conducted by the country, the IDB Group or other institutions) aimed at identifying the action priorities for the IDB Group. The diagnoses will be a basic input for the programming dialogue and for the inclusion of the agreed areas on improvements in competitiveness and sustainable and equitable development.

Institutionalization: For the definition of the institutionalization of the IDB Group's programs, effective institutional mechanisms will be developed to strengthen the capacity of governments and the private sector to formulate and implement strategies and action plans. In the formulation of programs, it is necessary to define the different levels of action of the public sector, regulatory bodies, executing agencies (public or private), and service providers (private) to make use of their abilities and capacities and reduce risks of market or policy failures resulting from asymmetries of information, high transaction costs or an inadequate allocation of responsibilities and resources.

Implementation: Among the participative processes for achieving national, sub national or sub regional consensus on policies and reforms, the Bank will support, where the political will exists, the preparation of National Competitive Strategies as a coordinated guide for the actions of government, private sector and the IDB Group. Some experiences of this type have begun in some member countries at the national and sub regional level, with the participation of different sectors of activity.

Among the specific programs, the Bank will support actions aimed at improving and fostering the quality, comprehensiveness, credibility and representative nature of the processes that lead to the formulation of programs. This requires the identification and implementation of a set of incentives to: (i) promote more systematic and open work with respect to timely access to financing resources and the adequate participative design of the program; (ii) systematically introduce the lessons learned and disseminate all the information used and generated, as well as the best practices; and (iii) coordinate, integrate and share with the IDB Group and the other pertinent financial organizations all the horizontal problems and the recommendations for their resolution. Similarly, to facilitate the measurement of impacts and the monitoring of programs, specific indicators will be developed for the sectors and sub-sectors involved. The design and implementation of these indicators will be essential for evaluating the programs. A preliminary and indicative list of indicators appears in Section 6.

The activities of the IDB Group can include programs both at the macro and microeconomic levels. At the macro level, they can include policy issues, such as fostering economic stability; fiscal equilibrium; provision of infrastructure; reform of regulatory systems; education and training of workers; etc. At the micro level, interventions can improve the business climate, directly assist productive sectors, or grant loans, investment capital and guarantees directly to companies in the region (especially through the IIC and the MIF). Business development services can also be offered to promote productivity, such as: business training, certification, consulting, support for information and communication technology, export promotion, etc.

Follow-up and Impact Evaluation: Finally, the programs must incorporate the tools necessary for performance monitoring and impact measurement. The IDB Group will give priority to flexible and timely access to technical

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

assistance on the ground, both during program preparation, as well as during their execution. The formalization of operating audits (complementing the financial audits) and technical audits (institutional, environmental, economic) during the execution of the programs, as well as the systematic generation of key indicators of outcomes and impacts, will permit the continuous assimilation of lessons learned and feedback to the programs themselves or to new ones, while developing the training of professionals, technicians, administrators and workers, in line with the demands imposed by the new programs.

The Bank will intensify the interaction with the private sector at the national and sub regional levels, with a view to informing them of the Bank's services and the mechanisms developed to facilitate the preparation of projects. The Bank will promote a policy dialogue to develop an environment and a set of policies favorable to investment and to the improvement of the competitiveness of the private sector.

Given the special set of problems related to the development of competitiveness in small countries, and in accordance with the Action Plan for the activities of the IDB Group associated with the development of the private sector in the countries of the C and D Groups (GN–2193), the Bank will give special emphasis in these countries to fostering private sector investment, for the modernization and use of technologies, for efficient and environmentally sustainable productive processes that comply with international standards of quality certification, as well as for the development of infrastructure and services, development and deepening of financial systems and capital markets, and development of rural areas. In these countries, projects to improve competitiveness face constraints, particularly related to the development, size and attitudes of the private business sector, scale of markets, development of the financial system, and knowledge of best practices. Specifically, in response to the high transaction costs for investment in modern productive processes and infrastructure in the countries of the C and D Groups, the IDB Group will promote the creation of new financial instruments (for example, private investment funds), based on the identification of problems and solutions in the processes for formulating the action plans to improve production, productivity and market penetration. The experience of IIC, PRI and MIF in similar funds in the Region will be extremely useful. These funds will contribute to identifying programs, attracting the interests of investors, and tapping funds from different sources. These funds will also be useful for capturing and channeling remittances into financing for programs in the private sector, which will stimulate savings. Additionally (as analyzed in greater detail in the Modernization of the State Strategy), it is necessary to develop and consolidate transparent public and private institutions for management of competitiveness resources, and an institutional capacity to design and manage the competitiveness programs.

The Bank will give priority to the design of competitiveness programs, with components focused on the poorest sectors, including initiatives and new approaches to increase the level of assets of the poor, the productive capacity of their economic activities, and their access to markets for goods and services, labor and finance.

Research, identification of good practices, and knowledge diffusion. The Bank must be at the vanguard in the generation and dissemination of knowledge of the factors that contribute to enhance competitiveness. A wide-ranging research and diffusion process was carried out on the subject with the preparation, publication, and presentation of the *Economic and Social Progress Report* of 2001. The Regional Departments, RES and SDS will continue this effort with the preparation and diffusion of more specific studies focused on countries, and on problems that

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

affect the operation of the markets for the main productive resources, taking into consideration not only the aggregate variables at the national level, but also the competitiveness factors in different territories, entrepreneurial segments, and productive sectors and sub-sectors. The topics to be studied include: business environment; access to financing; human capital; infrastructure services (electricity, telecommunications, roads, ports); generation, assimilation and effective use of technology and knowledge; productivity in the value chains; and development of entrepreneurial capacities. Emphasis will be given to the institutions and incentive systems required for the proper operation of factor markets and productive resources, taking into account the limitations of the countries and international experience.

Action Plan. The implementation of the Competitiveness Strategy requires a set of actions to strengthen its links with the programming exercises and the project cycle of the IDB Group. The specific actions to start up and implement the strategy, include the following:

- Sector diagnoses by country, sub national jurisdictions, or by sub-region or trading bloc, specifically identifying the bottlenecks and obstacles to business productivity, and the opportunities for developing comparative advantages and the competitiveness of the countries.
- Incorporation of lines of action to increase competitiveness in the Banks' Country Strategies, especially in the cases in which sector diagnostics reveal important limitations to businesses productive development.
- Support for the development of competitiveness strategies when considered pertinent, at the national, sub national or sub regional levels; as well as promotion and support for spaces for dialogue and negotiation for the competitiveness of the public sector with the private sector.
- Promotion of a more predominant role of the Banks' agencies dealing with the private sector (PRI, MIF, and IIC) in the design, financing, and execution of projects for competitiveness improvement.
- Support for the development of micro, small and medium enterprise, within the context of competitiveness strategies, which may include access to financing through efficient financial intermediaries; technical and managerial strengthening of enterprises; support to clusters and entrepreneurial productive chains; cooperation between large companies and SMEs; the dissemination and transfer of technology, and promotion of entrepreneurial innovation; and the training of entrepreneurs.
- Development of competitiveness programs with inclusion of components focused on improving the possibilities of income generation for the poorest sectors, including initiatives to promote efficient and sustainable technologies for production and marketing; improve access by the poor to infrastructure services and basic services (water, electricity, transport and telecommunications); training and labor market integration to raise workers' income; improvements in the property rights of the poor and other factors that affect their productivity; deepening of financial markets to permit access by small producers and low-income workers, including those in rural areas; development of productive chains between large companies and SMEs; rural development in marginal areas; and generalized support for microenterprises.
- Promotion of actions to facilitate coordination of efforts between all the functional divisions of the IDB Group, based on the achievement of the objectives and targets in the area of improvement of competitiveness.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

- Promotion of programs and projects to foster corporate social responsibility.
- Systematization of processes of lessons learned in the design and execution of programs in the area of competitiveness, in order to introduce best practices as needed in order to achieve quality results in the operations of the IDB Group.
- Creation of capacities at country and Bank level to evaluate the impact of the IDB Group's programs and projects in the area of competitiveness.

To implement the Action Plan, the Bank will pay special attention to the following areas: preparation of integrated diagnostic studies by sector; support for policies and programs in the borrowing member countries to improve levels of competitiveness; monitoring of targets and results of programs for improving competitiveness; and generation and exchange of knowledge at national and regional level on best practices in the programs and projects of the IDB Group and other regional and multilateral financing organizations in the field of competitiveness.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



MONITORING, EVALUATION AND PERFORMANCE INDICATORS

Mechanisms have to be set up to monitor the advances in the implementation of the strategy, and their relation to the strategies for the fundamental objectives and priority areas of the Bank, through the establishment of a system of indicators, monitoring and evaluation of policies and programs. The Bank's support for the development of monitoring and evaluation capacities in the borrowing member countries will be of vital importance for improving, modifying and adapting policies and programs on the basis of agreed upon actions and lessons learned. Evaluations of results and of impact of programs and projects to improve competitiveness must also be undertaken, jointly with the countries. The design of the programs must include the elements required for a careful evaluation of the results and impacts.

The strategy must be results-orientated, which means capacity to monitor and evaluate the actions of the IDB Group in the countries. This task will be based on the Bank's work to improve measurement of the effectiveness of the operations (e.g., consolidation of each phase of the project cycle; programming and design of projects focused on goals; execution focused on results; systems for monitoring performance and evaluation; and ex-post evaluation of results and impact).

The implementation of the Strategy will be monitored through output, outcome, and impact indicators. However, due to the multiple factors that can affect competitiveness, and the impossibility of establishing a direct correlation between the Bank's action and the evolution of these factors, the evaluation through intermediate indicators, as described in the following paragraphs, will necessarily be limited. To overcome this, evaluation by indicators will have to be supplemented with other methods. First, the independent ex-post evaluations of operations by OVE and the borrowing member countries should be continued. Second, the Bank will make efforts to develop methodology to evaluate the effectiveness of projects and specific programs, and to incorporate these methodologies into the design of new projects and programs. Ex-post evaluation will be difficult to undertake if the mechanisms and monitoring systems for generating the necessary information are not incorporated at the beginning of the projects and programs.

Output indicators: At this level, the intention is to measure the Bank's contribution to improvements in competitiveness. For each country, the priorities will be reflected in the Country Strategies and Programming Memoranda, which will recommend the specific activities and operations. The monitoring will form part of the periodic documents for the review of the execution of the Bank's portfolio in each country, and be based on the indicators proposed in the Country Strategies. Additionally, as proposed in the Action Plan, diagnostic and sector studies will be prepared, and assistance will be provided to the borrowing member countries that request it to prepare strategies and programs to promote competitiveness. In particular, before 2005 it is proposed to incorporate in Country Strategies actions to improve competitiveness in the case in which the comprehensive sector diagnostics identified important bottlenecks to firm productivity development.

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

Outcome indicators: Results of financial operations and nonfinancial products geared towards improving competitiveness have to be prepared. During the design stage of operations, outcome indicators will be defined, in order to facilitate monitoring.

Impact indicators. At this level, the intention is to measure progress in achieving the objective of the strategy, which is to improve the level of competitiveness of the countries, and, ultimately, improve the overall conditions for developing the private sector and increasing factor productivity, in an effort to enhance the quality of life of the population. To measure the progress of the environment for the sustainable development of productive activities, the Bank proposes to use the system of indicators of the *Global Competitiveness Report*. Currently the Report covers 21 countries in the region, and the following areas of competitiveness: i) general indicators; ii) macroeconomic environment; iii) technological innovation and dissemination; iv) information and communication technologies; v) general infrastructure; vi) public institutions (contracts and laws); vii) domestic competition; viii) development of clusters; ix) corporate strategies and operations; and x) environmental policy. This system includes objective indicators in each of these areas, as well as indicators of perception, based on surveys of executives in the countries. An additional advantage of this system is that its broad coverage (currently 80 countries), which provides a basis for establishing international benchmarks in line with the level of development of the countries, with a guaranteed annual frequency. The Bank has established an alliance with the World Economic Forum to contribute to the development of this system of indicators. The Social Development, Modernization of the State, and Environment Strategies, contain other indicators that supplement those proposed here. In all cases, the identification of impact indicators requires prior research to establish the relationships of these indicators with the interventions and policies.

The strategy will be evaluated five years after its approval.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



ANNEX

Areas of Action for the Bank and their Relation to the Sustainable Economic Growth and Poverty Reduction Strategies

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
A. Financial And Capital Resources	**Accessibility to Financial Resources**	**Expand Financial Resources for the Poor**
Objective: Increase the access of firms to financial resources to increase their productivity and promote social equity.	*Objective:* Increase availability of financial resources for productive activities.	*Objective:* Ease access to financial services for microenter-prises, independent producers, and poor workers and households.
• Financial legislation	• Promote the development of the financial system to increase private sector access to financing.	• Financial deepening enables access of the poor to financial services.
• Financial regulation	• Guarantee financial sector stability.	• Protect deposits, especially those of small depositors.
• Capital markets	• Promote competition and increase the efficiency of intermediation.	• Promote competition and efficiency in the financial intermediation, to reduce the cost of credit and other financial services to the poor.
• Strengthening of assets property rights	• Improve property registry and guarantee systems.	• Improve property titling in rural and urban areas, access to land, registration systems and guarantees, for the poor.
• Improve access to micro finance	• Create and consolidate micro finance systems in countries with appropriate institutional framework and improve institutions responsible for managing credit rating systems.	• Improve and expand access to financial services for small producers, micro-enterprises, and poor workers and households.

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
B. Human Resources	**Improvement and efficient use of human resources**	**Improve employment options for the poor**
Objective: Support training programs, and labor reforms, to enhance labor productivity and inclusion.	*Objective:* Support training and labor legislation reform to enhance employment and productivity of the labor force.	*Objective:* Labor reform and training for small entrepreneurs, small producers and workers, to improve their employment and productivity.
• Reform training Systems	• Reform public training institutions to make training more relevant to the companies' needs.	• Improve institutions to promote investment in training for the poor.
• Training of employers and workers	• Design training programs to foster entrepreneurial development.	• Improve productive capacity of microenterprises by facilitating access to training services and programs adapted to the specific needs of Micro and SME's.
• Labor legislation	• Modernize labor legislation to promote the efficient use of human resources.	• Remove obstacles in the labor market to facilitate the insertion of low-skilled workers.
• Strengthen labor intermediation systems	• Improve labor intermediation to increase employment and productivity.	• Reduce unemployment of poor workers.
C. Infrastructure Services	**Improve delivery of infrastructure services**	**Enhance inclusion by expanding access of the poor to infrastructure services**
Objective: Improve access to infrastructure services to increase productivity and competitiveness.	*Objective:* Expand access to basic infrastructure services.	*Objective:* Increase access to basic infrastructure services in marginal areas.
• Regulatory frameworks for provision of infrastructure	• Setting-up regulatory framework in infrastructure that would stimulate competition, increase efficiency and enhance quality and coverage of services.	• Further competition and increasing coverage enables access of the poor to infrastructure services.
• Infrastructure investment	• Increase financing for the provision of adequate infrastructure services.	• Increase financing for the provision of adequate infrastructure services in poor areas.

(continued on the next page)

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
• Restructuring and privatization of state companies	• Support restructuring and privatization processes of state enterprises to increase coverage and efficiency in the provision of infrastructure services.	• Improve access of the poor to basic infrastructure services-water, electricity, transportation and telecommunications — through adequate technology and sustainable systems.
D. New Technologies	**Assimilation and development of new technologies**	**Expand access of science and technology to the poor**
Objective: Promote the development and assimilation of new technologies.	*Objective:* Promote knowledge assimilation and the dissemination of new productive technologies.	*Objective:* Promote the diffusion and assimilation of adequate productive technologies among micro and small-size enterprises and agriculture producers.
• Diagnose science and technology systems	• Evaluate national innovation systems to identify strengths and weaknesses.	• Identify opportunities to develop and adapt technologies that directly benefit the poor, especially in rural areas.
• Strengthen institutions for science and technology generation	• Support integrated programs and organizations that generate science and technology knowledge.	• Promote institutions that generate science and technology for poor farmers and small entrepreneurs.
• Strengthen intellectual property rights	• Improve property rights.	• Protect and promote traditional knowledge as part of local development programs.
• Accelerate technological improvement of enterprises	• Promote assimilation new technologies in enterprises.	• Promote dissemination of new technologies among small enterprises and producers.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
E. Cooperation for Competitiveness	**Promote cooperation between the public and private sectors to enhance competitiveness**	**Promote cooperation between the public and private sectors to enhance competitiveness of the poor**
Objective: Promote the modernization of public institutions that support private productive activities.	*Objective:* Improve the environment for private activities.	*Objective:* Improve the environment for the activities of small producers.
• Public-private sector cooperation to enhance competitiveness	• Promote dialogue and cooperation between the public and private sectors to enhance competitiveness and growth.	• Promote cooperation between the public and private sectors, including civil society groups and community organizations, to enhance productivity and growth of microenterprises, through the development of clusters, networks and subcontracting chains.
• Corporate Social Responsibility	• Increase factor productivity by improving labor relations and community participation.	• Generate benefits for workers, consumers, suppliers, among them the poorest.
F. Competitiveness and Natural Capital	**Promote sustainable management of natural resources**	**Environmental management for poverty reduction**
Objective: Preserve natural capital avoiding overexploitation and increased pollution.	*Objective:* Reinforce sustainable use of natural resources.	*Objective:* Avoid the vicious circle of poverty and environmental degradation.
• Preserve productive value of natural resources	• Reinforce the productive capacities of natural resources and guarantee their sustainability.	• Increase the income of the poor based on sustainable and efficient use of natural resources.
• Promote clean production processes	• Promote private sector involvement in environmental management to reduce production cost.	• Promote the development of poor local areas through eco-tourism and sustainable management of protected areas.
• Capitalize regional and global opportunities	• Increase growth using environmental comparative advantages.	• Take advantage of global and regional and environmental initiatives to improve the welfare of the poor.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

REGIONAL INTEGRATION

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This paper was prepared by Fernando Quevedo (Coordinator) and Luiz Villela of the Integration and Regional Programs Department (INT) with the collaboration of other INT colleagues. It is one of a set of strategies processed by Carlos M. Jarque (Manager, SDS). Valuable comments were received from an interdepartmental working group made up of Kelle Bevine (PRI), Juan Blyde (RE1), Gilberto Chona (RE2), Badrul Haque (RE3), Fernando Jimenez-Ontiveros (MIF), Héctor Salazar (EVP), José Seligmann (RE1), Graciela Shamis (PRE), and Ernesto Stein (RES). Among other Bank staff members who provided input are Walter Arensberg (SDS), Juan Benavides (SDS), Edgardo Demaestri (SDS), Luis Giorgio (RE3), Edmundo Jarquín (SDS), Eduardo Lora (RES) and Ricardo Quiroga (SDS). Xavier Comas (RE3), Felipe Gómez-Acebo (RE1), Jorge Requena (RE2) and other staff of the Bank also offered helpful suggestions and comments. Consultations with government and civil society representatives and academics at the country and regional level were organized in Argentina, Brazil, Canada, Costa Rica and Peru. Comments also were received via the Bank's web site. The paper draws also on the 2002 Economic and Social Progress Report Beyond Borders: The New Regionalism in Latin America, produced by RES and INT, and on background papers prepared by consultants Emil Weinberg and Ricardo Rozemberg. The authors gratefully acknowledge all these contributions.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

OBJECTIVE



The Inter-American Development Bank has been committed to regional integration initiatives since its inception, though it has had no formal umbrella strategy in place for its integration support.[1] This commitment was put into words by the first President of the Bank, Felipe Herrera, who in 1961 declared "We shall be the Integration Bank." The Bank's support for integration gained new impetus as one of the core mandates of the Eighth Replenishment. Further reinforcement for its commitment was provided in the Institutional Strategy, which made regional integration one of four priority focuses for Bank support, with the ultimate aims of environmentally sustainable economic growth and poverty reduction with enhanced equity.

The central objective of the Bank's regional integration strategy is to guide the institution's support for the creation of regional public goods (RPG), specifically (i) *regional integration* and (ii) *regional cooperation*, so as to maximize the impact of the resources available. Regional integration is a process involving formal agreements whereby the partner countries acquire rights and obligations to end discrimination in the movement of goods, services, labor and capital. Policy and institutional harmonization are sometimes an added feature of these accords. "Regional cooperation" refers to cooperation not related to undertakings in an integration treaty. In pursuing the activities proposed in the present strategy the Bank would need to take due account of the countries' goals, the state of their development processes, appropriate policy sequencing, multilateral rules, and potential contribution to development.

Regional integration is not an end in itself: it is one more policy instrument for achieving a set of development goals and objectives. The first Post-War integration initiatives in Latin America and the Caribbean (LAC) were designed to advance and deepen an import-substitution industrialization strategy, bolstered by substantial external protection and State intervention. This economic development approach lost currency with the economic crisis of the 1980s, and the underlying integration arrangements collapsed. The 1990s saw the emergence of fresh regional integration initiatives with a different thrust, as befit the altered global economic policy backdrop. Today regional integration is an integral part of the structural reforms under way in the countries since the 1980s. As such, it complements other policies the countries have crafted in order to integrate their economies with the rest of the world, foster private markets and modernize institutions, with a view to positioning themselves firmly in a globalizing economy, transforming production patterns, and making themselves more competitive. The ultimate goals of the process are to spur environmentally sustainable economic growth, improve social equity, foster peace and democracy, and reduce poverty in line with the Millennium Development Goals (MDG).

The tangible expression of this process, which some experts have dubbed the "new

[1] The Bank has been preparing strategies for LAC subregions in its regional programming papers for many years.

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

regionalism,"[2] has been a wave of formal integration agreements and major regional cooperation initiatives. These initiatives had their origin in traditional subregional forums but, as the process has advanced, a web of bilateral and interregional initiatives has taken shape. There also has been a growing trend toward agreements with industrialized countries.

Regional integration agreements in Latin America and the Caribbean foster, first and foremost, trade between the partners, affording reciprocal, preferential, unfettered market access. References to "trade" in this paper refer to trade in both goods and services. Some accords confine their ambitions to a "strictly business" free trade area, while others strive for 'deeper' integration. This term refers to integration that goes beyond increasing trade relations to take in possible labor and capital market integration and coordination of institutional activity. In some cases, it can be seeked by creating a common external tariff (CET) as a step toward a customs union or common market. Generally, regional cooperation in both the economic and noneconomic spheres has been driven *ad hoc* by growing interdependence—the result of strengthened trade ties or the desire to forge solid common geopolitical strategies to operate in the globalizing marketplace.

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. For instance, countries are combining regional integration with unilateral and multilateral trade liberalization in order to lower average protection levels and spur competition, create trade, and help realign their production apparatus. This is accomplished by creating a rules-based preferential regional market conducive to export diversification, economies of scale, greater specialization, productivity, and attraction of foreign direct investment. Integration agreements, with the legal commitments they demand of participating countries, also make it harder to backtrack on reforms.

This paper is one of a package of Bank strategies: two that pursue the twin core objectives of the Bank's Institutional Strategy —*poverty reduction and social equity promotion and sustainable economic growth*—and strategies addressing the Bank's four priority action focuses: *modernization of the State, competitiveness, social development, and regional integration*. All these strategies have been developed following a common format. Bank actions posited in the different strategies are intertwined and mutually reinforcing. An environmental strategy with these same features has been developed. Within this umbrella framework, the regional integration strategy will help guide the use of the Bank's toolkit of financial and nonfinancial products as well as its internal organization, to assist LAC countries by furthering regional integration and cooperation. The actions being proposed are based on an analysis of the achievements and shortcomings of regional integration and cooperation and on an evaluation of Bank activities in support of those processes. From the analysis findings this paper outlines a series of work focuses, prioritized in light of the requirements of regional integration and cooperation processes and the comparative advantages the Bank offers to help further these processes.

[2] The 2002 Report on Economic and Social Progress (IPES) has a larger analysis on the new regionalism and on the contribution of regional integration on global integration.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



The forces of globalization and liberalization at work the world over have been driving *de facto* integration of the global economy in goods, capital, labor and technology markets. Since 1990 there has been appreciable progress in regional integration, creating an adjunct policy space in which to manage the forces of globalization and use them to propel the region's development.

Reciprocal preferential trade liberalization in regional agreements has been relatively swift, universal, and in line with World Trade Organization (WTO) agreements. Accordingly, the close to 30 accords sealed to date have for the most part succeeded in creating trade, diversifying exports, increasing specialization and attracting investment. Time will tell what effects they will have on boosting global competitiveness.

A number of free trade agreements have advanced to the "second generation" stage, addressing new issues regarding services, investment, intellectual property and others. The subregional pacts enter the realm of collaboration in international trade negotiations, incipient macroeconomic cooperation, greater labor mobility, and collective initiatives to preserve democracy in partner countries. Large-scale cooperation within subregions and beyond the region also has emerged in plurilateral initiatives that take in a whole spectrum of economic, social and political issues.

The benefits that participating countries stand to gain from 'deep' integration are undeniable but, because of the varying strength of the underlying political commitments, the subregional integration accords have made limited progress in strengthening ties, fulfilling objectives and improving compliance with the rules adopted. Other hurdles on this front have been weak points in the design of the original agreements and difficulties in securing a consensus to remedy these constraints, economic and partisan-politics crises, and asymmetries in the benefits and costs accruing to the partner countries.

As LAC countries put through structural reforms to move their economies into the global marketplace they turned their attention increasingly to integration arrangements with industrialized nations. Driving this trend was the desire to augment the benefits stemming from integration in the subregions. One distinct benefit of such agreements is assured access to major markets, creating entrées into heavily protected sectors in which LAC has competitive advantages. In addition, such agreements expose the subregions to a set of comparative advantages simulating the ones they would confront multilaterally. This kind of exposure helps minimize trade diversion and fosters productivity.

Negotiations for a comprehensive, balanced Free Trade of the Americas Agreement (FTAA) that would take in 34 nations in the hemisphere are moving forward. The FTAA initiative became more complex when many countries decided to pursue parallel bilateral free trade agreements—a move that can serve both as a building block and a stumbling block for pan-American integration, depending on the precedents it creates.

Trade integration arrangements with the European Union (EU), another core objective of the new regionalism, could yield benefits similar to the FTAA's. Though the EU now

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

has formal trade agreements with Mexico and Chile it has shown a certain ambivalence about accelerating negotiations with MERCOSUR because of its sensitivity over agricultural liberalization. Progress on these talks and prospects for launching EU-Central America and EU-Andean Community negotiations would appear to hinge on eventual Doha Round agreements. CARICOM might finalize a free trade agreement with the EU before 2008. Negotiations to work out a free trade agreement in APEC (involving Chile, Mexico and Peru) have lost momentum.

Though they do not involve regional integration, the Doha multilateral talks are extremely important since they have to do with global market liberalization. Also on the table at that forum are some systemic issues that are critical for North-South relations but are difficult to tackle in regional talks (e.g. abolishing agricultural subsidies). The scant progress made thus far in these talks raises doubts about the 2005 target date for the wind-up of negotiations.

Throughout the 1990s, LAC countries continued to lower economic barriers and boost trade flows, regional integration being one facet of this larger liberalization strategy. Countries did gain from these moves to unfetter their economies, but the results of the process on sustained economic growth and poverty and inequality reduction were mixed or indeterminate. This would appear to belie the widely held view that more open economies and increased trade yield net benefits across the board. Even when the net benefits were undeniable they were not necessarily widely or evenly distributed. Not all countries in the region were able to tap all the opportunities afforded by their integration with the rest of the world, owing to serious institutional shortcomings, weak negotiating capacity and bargaining power and, in some cases, insufficient macroeconomic stability. In many countries no compensatory mechanisms were put in place to make sure that the net benefits of trade were distributed more equitably.

Though great strides have been made in trade liberalization there still is much work to be done to reap all the potential fruits of regional integration and ensure that all the parties receive their fair share of those benefits. This is a very complex agenda, requiring simultaneous action on multiple fronts, a resolute collective vision and political leadership, particularly in integrating countries with dominant markets.

The trade and integration agreements operating in the four subregions—CARICOM, Andean Community, Central American Common Market and MERCOSUR—have common-market objectives. Among the benefits of 'deep' subregional agreements are bolstered international negotiating capacity, international competitiveness (thanks to unrestricted movement of factors of production, harmonized policies and rules, etc.), and cooperation in managing common problems. However, constraints in a number of areas have kept countries from realizing all of integration's potential benefits: (i) the persistence of major nontariff barriers; (ii) failure to finish implementing genuine customs unions and serious perforations of common external tariffs; (iii) slow progress on instituting "second generation" protocols; (iv) inadequate regional infrastructure; (v) weaknesses in the regional institutional apparatus (and in the national counterparts); (vi) unfinished country structural reforms; (vii) scant coordination of macroeconomic and sector policies, and tax systems that do not work for integrated markets and do little to stimulate external trade and investment; (viii) no mechanisms to promote socioeconomic development such as would compensate for asymmetries in the different integrating zones and regions, within individual countries and between partner countries; and (ix) international barriers to exports. A further constraint for the delivery of RPG is the suboptimum level of regional cooperation.

If countries have yet to feel the full benefit of liberalization as they dismantle tariffs on

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

trade with their integration partners it is because of the persistence of *nontariff barriers*, typically in the form of customs procedures, technical standards, surcharges, etc.

One key avenue for deepening regional integration is the *formation of a genuine customs union*. This does away with the need to administer rules of origin and assures the operation of common customs procedures along with regional mechanisms for tariff revenue collection and distribution. A customs union also facilitates en *bloc* negotiations with third parties. Such a union is an aspiration of all the subregional agreements, but this goal is still a long way off. Some progress has been made on common external tariff implementation but such tariffs are not fully operational or there have been serious perforations. Furthermore, members of a customs union frequently negotiate on their own with third parties, thereby aggravating the perforation and eroding the subregional bloc's bargaining power.

Subregional agreements have made slow progress on *implementing second generation protocols*, missing out on the opportunity to deepen integration and spur structural reforms by explicitly including services (notably financial services), investment, government procurement, intellectual property rights, etc. Specifically, little has been accomplished in efforts to expedite financial deepening, taking advantage of scale economies and diversifying risk.

LAC countries' infrastructure investments have not done much to further integration: as a percentage of GDP their infrastructure outlays have declined over the past two decades, dampening fast-growth prospects. Country fiscal constraints and the need to address environmental sensitivities were two factors at work here. The infrastructure projects that did come to fruition failed to address all the positive externalities that could have been captured had there been inter-country coordination. Consequently, these investments have lacked a regional vision and collective mechanisms that could have multiplied their development impact and their effect on regional integration. Further regulatory harmonization to soften regulatory barriers is another observed need. Two recently launched initiatives—the Puebla Panama Plan (PPP) and Regional Infrastructure Integration in South America (IIRSA)—offer promising prospects to overcome those impediments in the energy, transportation, and telecommunications sectors. In both initiatives there are provisions for civil society participation and proactive environmental protection.

The PPP, an integration initiative for the Central American countries and Mexico, is fostering cooperation to accelerate economic and social development and advance integration in the participating countries, with careful attention to environmental considerations and the interests of local communities. The eight key cooperation areas are: sustainable development, human development, natural disaster prevention, tourism promotion, trade facilitation, highway system integration, electrical interconnection, and telecommunications development. The specific goal for Mexico is to compensate for development asymmetries—a NAFTA effect—between that country's north and south. Substantial progress was made on infrastructure ventures in 2002, with the ratification of the Bank-supported SIEPAC power grid project and an agreement on the International Network of Meso-American Highways.

The purpose of IIRSA is to improve coordination of infrastructure development plans, modernize regulatory systems and harmonize transportation, energy and telecommunications policies across South America. This initiative, based on nine integration hubs and eight sector integration processes, proposes to bring to a regional level the binational and subregional physical and economic integration processes the countries have been pursuing for a decade, as a means to improve productivity and competitiveness. It will help improve energy and communications regulatory frameworks and markets for logistical

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

services such as shipping, insurance, warehousing and licensing, and spur the formation of integrated regional energy markets. The ultimate goal is to improve the quality of life and opportunities for local populations in the regional integration hubs, taking careful account of the social and environmental dimensions of infrastructure projects and building consultation and participation mechanisms.

Weaknesses in the regional institutional apparatus and in the national counterparts have held back the development and effective implementation of integration initiatives, the development, monitoring and enforcement of rules and the use of dispute resolution mechanisms, and have made it difficult to dispel economic agents' uncertainty and to address problems quickly. According to "functionalist" approaches, economic interdependence creates natural incentives to augment cooperation, lower transaction costs and develop common regulatory regimes. However, there is no clear evidence that the increasing interdependence of LAC economies has significantly stiffened the regional institutional fabric in the process. "Realist" approaches hold that regional institution-building incentives come out of the hegemony, collective vision and leadership of their major members, so there need to be incentives for those members to spearhead the process with an eye to the common good. Leadership in LAC subregions has been inconstant and marked by the 'leader' countries' economic and political vulnerabilities. Ultimately, both these approaches have their place in any successful process, and they interact as the process unfolds.

Structural economic reforms have helped augment regional integration's benefits, improving macroeconomic stability, opening economies even further to the global marketplace, lessening direct State intervention in markets, and creating an enabling environment for private enterprise. However, the impact of sharp reductions in external capital flows to the region, particularly in the Southern Cone, has underscored the persistent vulnerabilities that are dampening growth and worsening the income distribution, slowing the integration impetus.

Insufficient *macroeconomic coordination* as countries became more commercially interdependent by virtue of integration agreements increased the transmission of macroeconomic instability not just directly—with a falling-off of economic activity and trade—but also indirectly through the heightened risk of contagion in global financial markets. These problems were compounded when some integration partners adopted incompatible exchange regimes.

Moves by member countries in LAC subregions to dismantle trade and financial barriers and pursue regional integration were not accompanied by even a minimal *harmonization of tax policies*—not even taxation coordination mechanisms. The result was distortions in traded products' competitiveness conditions and in project returns, affecting investment localization decisions. The governments' reaction to this situation led to unfair competition, harmful tax practices and fiscal degradation.

The lack of *sector policy coordination* held back the development of regional production chains, making it more difficult for many products to achieve the productivity levels that are essential to compete with third markets.

Since there were no *national and regional policies to compensate for asymmetries* in the distribution of integration's benefits, there was no way to protect or compensate segments of the population that had come out losers in the trade liberalization process. This, coupled with the lack of real opportunities for consultation and dialogue with civil society, sparked a mobilization against integration moves, particularly North-South initiatives.

The region's export trade is being hampered by protection being afforded to sectors that the industrial economies consider to be polit-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ically sensitive. Typically these are areas in which LAC has distinct international comparative advantages (agriculture, textiles, footwear, steel, etc.)—this being one of the factors that prompted countries in the region to explore free trade agreements with the North and to participate actively in the Doha Round. But there are considerable differences in the participants' capacity, with the smaller economies at a definite disadvantage.

Not many LAC countries fully tapped into the resources available for strengthening negotiating capacity and the capacity to implement trade and competitiveness agreements. Unfortunately the magnitude of the problem is such that many countries find it difficult even to systematically identify the support they need in this sphere. Many countries' development strategies have not put this issue front and center, so external assistance has not been made a priority. Meanwhile, donors and international lending agencies have not effectively coordinated the delivery of this kind of support.

The 1990s integration initiatives that triggered new trade and investment flows also engendered close to 30 agreements in the region, creating costs because of the so-called 'spaghetti bowl' of rules and regulations they created, with the concomitant lack of transparency and higher transaction costs for trade. One expectation for the proposed FTAA is that it might be a way of absorbing some of the simpler agreements, thereby lowering these 'spaghetti bowl' costs.

One recent development of note is the emergence of large-scale *regional cooperation* between subregions. This has been one way of furthering progress on important fronts without entering into the complexities of integration treaties that demand greater commitments. Two prominent examples are the IIRSA and PPP initiatives discussed earlier, which are moving resolutely ahead with technical and logistical support from regional organizations. Considerable activity also has come out of hemispheric summits, LAC-European Union cooperation, and in APEC. Some of these initiatives already have borne significant fruit, such as democracy clauses and other agreements regarding security and corruption.

One hurdle to trade agreements, particularly North-South compacts, is the introduction of labor and environmental issues and the possibility of enforcement via trade sanctions. The developing countries fear that these standards will be used with protectionist intent and that the use of sanctions will have asymmetrical effects for them. The frequently expressed fear of countries in the North is that erosion of these standards could become an unfair-competition mechanism.

LAC countries have not seized all the opportunities available for the management of regional public environmental goods, such as water resources use and development in shared watersheds, development of a biological corridor, ecotourism promotion, etc.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



LESSONS LEARNED

LESSONS LEARNED: FROM THE STANDPOINT OF THE INTEGRATION PROCESS

Not all integration processes are identically sequenced, nor do they follow textbook logic, because they are eminently political processes. This is why the European Union experience, though it can serve as a point of reference, has not turned out to be a straightforwardly replicable model. It is no easy task to follow, in order, its successive stages from free trade area to monetary union.

Regional integration and cooperation demand political commitment at the highest level, and they require sustained leadership. The participating countries—particularly those with the largest markets—have to take a medium-range view. Other requirements are support for ex ante and ex post evaluations of the development impact of integration processes, calculations of the cost of not moving ahead or of reversing course, public forums and avenues for consultation and discussion of these issues, and help in disseminating educational material. The countries have made only modest progress in these areas.

A necessary feature of subregional or extraregional integration agreements is the swift consolidation and preservation of secure preferential access to regional trade and investment markets. Indeed, such access is an essential "glue" for deepening integration.

When regional tariff reductions go hand in hand with economic liberalization moves there is less risk of trade and investment diversion. Excessive preferences or overvalued currencies can generate an intraregional trade in which "regional goods" not readily tradable in world markets are over-represented, creating situations of commercial hyperdependency among the regional partners.

Abolishing tariffs is the "easy" part of integration. The subsequent steps—erasing nontariff barriers, second generation liberalization, formation of customs unions, and macroeconomic coordination—have far greater domestic policy and country sovereignty implications.

Customs unions can do much to facilitate regional trade, bolster bargaining power in world markets, and soften incentives for the stiffening of external protection. They also are a precondition for creating a common market. However, it has proved very difficult to construct full-fledged customs unions in LAC subregions. When customs unions and common external tariffs languish for very extensive periods at a rudimentary stage, the participating countries incur heavy costs but capture no benefits. In such a scenario it is preferable to explore simpler, less ambitious alternatives such as perfecting a free trade area, incorporating "second generation" protocols and making sure that commitments are fulfilled to the letter.

Efforts to boost trade and further regional integration can be frustrated if the regional infrastructure needed to connect national markets and underpin increases in goods and services flows is not in place—hence the importance of support for increases in infrastructure investment, with private-sector participation. Because there are significant externalities in this sphere it is important that the countries coordinate infrastructure

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

development, taking a regional perspective. However, 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.

Though large-scale regional cooperation ventures like IIRSA, PPP, and the hemispheric agenda may not bear the same measure of political commitment as formal integration pacts, they do need political support from the partner countries at the highest national and sector levels, a prominent place on their agendas, forward-looking timetables with specific collective work programs, progress benchmark reviews, supervision, and monitoring. Solid collective logistical, technical and financial support for these initiatives is needed as well.

One crucial element for successful integration is institutional development. Transparent, equitable regional rules (with formal contingent mechanisms) need to be developed, as do functional regional institutions and their national counterparts, equipped for regional policy formulation, coordination and implementation. An important factor for regional policy development, to judge from successful 'deep' integration experiences, is that in every such process there needs to be an expectation of significant political integration—understood as the progressive convergence of countries' legal and political systems—and supranational bodies to propel this kind of convergence. Realistic roadmaps and timetables are a necessary adjunct for agenda setting, with fallback positions that help maintain forward momentum. Yet another requirement for regional integration to work for the partners individually and as a bloc is efficient national counterparts for the regional-policy sphere.

There is no cookie-cutter model of the institutional machinery for formal integration agreements, which takes a variety of forms. Some arrangements are "static" contractual undertakings like NAFTA which lay out, up front, explicit rules and member obligations. Other variants are more along the lines of the Treaty of Rome, a "dynamic" constitutional agreement with legal autonomy and prescribed procedures for decision-making and further rule-making. Formal regional institutions to undergird integration processes are more of a necessity in agreements that feature an institutional framework like these "dynamic" accords. However, as countries become more commercially interdependent the demand for formal institutions even for "static" agreements may increase as well.

Recognized, respected regional institutions are a must to gain credibility with governments, private enterprise and civil society and enable integration processes to transcend the vagaries of domestic political cycles. In the absence of technical secretariats, or where secretariats have been weak, some partner countries have found it difficult to move forward initiatives and have ended up creating ad hoc intergovernmental forums instead. (The technical-secretariat problem also causes difficulties for external donor support, since donors require a national counterpart to implement collective projects.) The higher costs this can entail in overlaps or redundancies is just one part of the problem: this situation also is particularly harmful to partners with weaker capacity, which are more reliant on support from technical secretariats to come up with balanced decisions.

Improving regional and country institutions will enhance compliance with regional rules. To solidify regional integration processes there needs to be a much narrower gap between commitments assumed and commitments honored. Some measure of flexibility is needed in the short term but, in the long run, growing economic interdependence in a volatile economic climate will require voluntary adherence to the regional commitments assumed and the ability to resist domestic pressures to reverse them. A more construc-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

tive way of channeling private-sector and civil-society demands is to create formal consultation and information forums with country and regional authorities.

One regional institution in particular need of improvement is dispute resolution mechanisms. Their primary role is to support and facilitate cooperation between the member countries and foster equitable application of rules. The absence of formal dispute settlement procedures or, where procedures are in place, serious weaknesses in their administration, hurt the smallest member countries most. There is a range of dispute resolution mechanisms, from those that are empowered to take binding decisions to those that can only hand down nonbinding opinions. If, in the latter scenario, there are significant power differences between the partners, the smaller ones find themselves at a disadvantage. Transparent mechanisms that help narrow the wide power gap between countries that are parties to an agreement are a definite asset to be able to sustain mutually beneficial economic, trade and political cooperation ties. Such arrangements can often keep commercial disputes from escalating, thereby helping to deepen integration. Transparent, uniform, predictable dispute settlement also helps dispel uncertainty, creating a climate in which economic agents will want to invest in the most efficient geographic area of the regional market rather than in the largest national market.

The success of regional integration initiatives hinges heavily on local market factors. Effective domestic policies and democratic institutions are needed to ensure that the fruits of integration are equitably shared across society, to afford social protection and to instill conditions for socially efficient adjustment, in an environment of heightened competition and economic transformations that undoubtedly improve the general welfare but create some losers as well as winners. Small and mid-sized businesses and marginalized sectors should come in for special attention to make sure that they too share in integration's benefits. One special focus should be an assessment of policy options for protecting those who are most likely to lose out in the early stages of integration, for example, policies on employment training and job search programs, unemployment insurance, and social safety networks.

Lasting macroeconomic stability in integration partners is essential to capture the benefits of regional integration. While greater integration with global capital markets is a positive development inasmuch as it enlarges the range of funding sources, it has brought greater risks as well, leaving economies more vulnerable to abrupt shifts in capital flows. Intraregional trade is especially vulnerable to systemic restrictions on international short-term trade finance. Furthermore, the region has no efficient payment systems or mechanisms of its own to be able to minimize the inherent risks of international transactions.

There needs to be greater macroeconomic coordination in the subregions to help preserve stability and propel integration. The demand for coordination will depend on: (i) how interdependent/dependent the economies are; (ii) political objectives regarding the depth of the integration process, and (iii) the need to earn greater credibility for domestic economic policies by "tying" certain instruments to regional commitments, to modify economic agents' perceptions of these policies. The effectiveness of such coordination will depend on the partner countries' credibility, the rules adopted, and how strictly the rules are observed.

The demand for this kind of coordination is on the rise as integration processes boost regional trade flows and heighten the risk of financial contagion in the subregional group. Externalities become very important here, as economies find themselves more exposed to price and quantity impulses in the rest of the world, notably in the principal trading partners. How intense such spillovers will be and how they spread will depend on the level of

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

interdependence,[3] so as integration processes move forward, collective policy formulation by way of some form of commitment will make good sense. However, there is a risk that any such commitment could be perceived as curbing some country's autonomy or that its implementation cost will be judged to be too high. In sum, there is a scale of macroeconomic coordination possibilities, ranging from simple data exchanges to country institution-strengthening pledges to the charting of macroeconomic convergence goals. Whatever the degree of commitment decided on, it is important that there be an institutional apparatus that works, that concrete goals have been adopted and that there be incentives to achieve them, taking care not to lose credibility or damage reputations in the event of any deviation.

Differences in exchange-rate regimes between integration-agreement partners can trigger serious tension or protectionism or erode consensuses. Moves to align exchange systems, together with predictable exchange-rate management, can spur trade and regional investment. Though a monetary union poses enormous technical and political challenges, the endogenous convergence forces that go with such processes are an incentive for partners with 'deep integration' aspirations to at least explore that avenue.

Trade liberalization has had a pronounced effect on fiscal policy. The reduction, standardization and removal of tariffs has slashed tariff revenues and significantly lowered effective protection of domestic production. This, coupled with pressures for tax benefits and incentives to aid sectors or regions, has required a broadening of the tax base. Trade promotion efforts clearly will demand special attention on the tax policy side, since taxation systems contain hidden subsidies and barriers to trade in goods, services, and capital.

Despite the trade liberalization gains posted by LAC countries there is a perception of a lack of reciprocity on the part of the more advanced nations, even when their average tariffs are low. But those countries afford heavy protection to certain items like agricultural products and textiles in which LAC countries have distinct comparative advantages. In particular, the use of subsidies and their magnitude, negatively affect exports from several countries of the region. This debate is extremely important given the subsidies approved in 2002 through the Common Agricultural Policy of the European Union and the Farm Bill of the USA, and the possibility that agricultural discussions within the FTAA are affected by the delay of agricultural negotiations in the Doha Round. Negotiation is the only way to lower these hurdles to the region's exports, hence the importance of the FTAA, initiatives with the European Union and APEC, and the Doha Round.

There clearly are very positive synergies among agendas to deepen subregional agreements, North-South pacts like NAFTA or agreements with the EU, and between these arrangements and the gradual unilateral opening of economies and advance of the multilateral trade system. Initiatives on these fronts thus ought to move forward in concert, but this creates a heavy institutional and financial burden for Latin American countries. The scale and complexity of these North-South agreements pose major challenges. For one thing, coordinating plurilateral North-South regional initiatives and managing the logistics is a very complex undertaking. The collective technical and logistical support that regional organizations have continually made available to the FTAA since the idea for such a free trade area was first broached has been crucial to level the playing field, expedite the negotiations and

[3] Country size asymmetries can create problems. In such scenarios the demand for coordination would come from the smaller countries, the most affected by macroeconomic spillovers.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

help the participants come up with balanced agreements. One requirement for such even-handed agreements, and one that is essential for their sustainability, is country capacity building to be able to negotiate and follow through on commitments. The problem is extreme in the case of small economies, which are especially vulnerable. Agreements like the FTAA also need an institutional architecture that will help balance outcomes among the partners. Otherwise, there is a risk that the agreements worked out will be unsustainable, protectionist, and rife with political conflicts.

As the FTAA takes shape, bilateral agreements between countries or subregions can serve as building blocks provided the precedents set in the process are consistent with a comprehensive, balanced, development-oriented hemispheric agreement that takes due account of the smaller economies' vulnerabilities. Conversely, bilateral agreements that simply promote mercantilist policies could impede consensuses on construction of an FTAA, leaving the region with too extensive a web of hub-and-spoke type agreements, with the concomitant costs for transparency and efficiency.

As economies become more interdependent the demand for more harmonized national rules and procedures is mounting, particularly in the labor, financial, and environmental spheres. Other areas such as natural disaster prevention and mitigation and disease control also need to be addressed at a regional level, regardless of economic interdependency considerations. The opportunities afforded by ecotourism, forest conservation, and biogenetic resource use need to be tapped.

Though bilateral donors do have funding available for regional cooperation, particularly for trade and competitiveness improvements, it is difficult to identify the countries and areas most in need. Donor resource offerings need to be coordinated in order to further integration processes, avoiding unnecessary overlaps.

LESSONS LEARNED: FROM THE BANK'S STANDPOINT

The Bank has supported integration since it first opened its doors. True to its mission, it promoted the "new regionalism" born in the late 1980s. The forms of its assistance have evolved to keep pace with changing needs in the region. The initial target of support was reforms to unfetter the region's economies, one of the goals set out in the Eighth Replenishment document. The Institutional Strategy adopted in 1999 made integration an explicit priority, to foster development in the region. However, the Bank has never produced an institutional strategy paper dealing with support for regional integration.

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 interrelated and mutually reinforcing reasons: (i) the reliance on regional technical cooperation (RTC) funding in subregional strategy implementation; (ii) scant interface between country and regional programming and no thematic regional programs as an adjunct to the traditional subregional exercise; and (iii) insufficient connection between programming processes and project generation in the Bank.

Until a few years ago regional programming did not, in practice, make use of the Bank's complete support toolkit, having concentrated on RTC resources. However, as regional integration moves up on country policy agendas there is increasing demand within the Bank for a closer meshing of regional programming with the use of a greater range of Bank products. Regional programming should be a comprehensive exercise, promoting the use of the entire menu of the Bank's financial and nonfinancial offerings.

Though there was very little interface between country and regional programming

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

in the past, the two exercises have recently become more closely linked and the importance of accelerating and deepening this process is evident. As the two processes become better coordinated, regional programs can benefit from the knowledge of those who work mostly on country issues, while those working on country programs will gain a regional perspective of the repercussions of initiatives in their respective areas. This change is evident in the 2001 Central America programming exercise, as documented by the Office of Evaluation and Oversight (OVE), and should become the general practice. Some integration and trade issues need to be tackled independently of the existing regional blocs; to that end, it would be useful to do thematic programming on border region development, migration, infrastructure, environment, and other topics.

Tighter regional/country programming coordination has been shown to be only the first step toward more structured support for integration. The second step is to make sure that projects selected for support are consonant with the programming exercises. The Bank has been instituting measures to make sure that its projects fit more closely with these programming processes, which will shorten approval procedures for operations that are included in approved strategies.

Since countries' support needs can change abruptly when they are confronted with unanticipated external shocks or natural disasters, it is likely that some proposed projects will not fit the approved strategies. In that scenario there need to be assurances that the new projects, too, will be able to make the most of their regional potential. The Bank should strengthen its internal procedures to make sure there is a regional perspective in such country projects from the outset, by intensifying cooperation between INT and the Regional Operations Departments.

Many of the Bank's contributions to regional integration have not shown up in the statistics as integration support because of how this assistance was classified. The Bank should improve its project classification procedures to provide a truer picture of its support for integration processes.

Regional integration and cooperation fit the definition of classic public goods: they entail externalities and commitments, with coordination problems stemming from information asymmetries and the credibility of commitments. This tends to make for suboptimum cooperation levels. In an era of government funding constraints this situation creates a niche for a variety of financial and nonfinancial products and facilities of regional development banks like the IDB. Indeed, given its lifelong regional focus and mission, its credibility with borrowers and lenders, its financing facilities, and its wealth of experience in regional integration, the Bank can act as a catalyst to bring countries together in collective endeavors that serve their mutual interests and advance their economies.

The Bank has superior financial products and human resources with which to help improve regional infrastructure. However, in some situations its activity has been limited by member-government funding constraints. It thus is important to bring the private sector into regional infrastructure modernization and expansion ventures.

With the FTAA, PPP, IIRSA, and hemispheric summits the Bank has developed another specialized niche: collective organizational, logistical, technical and financial support, working in concert with other regional organizations. This collaborative support for large-scale initiatives has been vital for their birth and growth. The Bank contributes with its staff's knowledge and its institutional neutrality to ensure homogeneous, quality services for all participants.

A salient consideration here is that the Bank's integration support has been affected by the reduction in nonreimbursable technical cooperation funding available (FSO net income) presented in Resolution AG-1/99.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This has significantly diminished the Bank's capacity to offer the kind of support it had been providing for years to regional integration institutions and their programs. Some recent figures tell the story: regional TC approvals peaked in 1996 at US$42 million and averaged US$30 million annually in 1995-1998 following the Bank's reorganization. The 2000 total was barely US$13 million.

The previous chapter underscored the importance of strengthening the regional institutional apparatus. The weakness (in some instances, the absence) of technical secretariats for subregional agreements has left the Bank without effective regional interlocutors to channel its integration support. An equally serious concern is that without the nonreimbursable support the Bank has been providing to integration groups it is highly unlikely that those institutions will be strengthened. The shrinking of regional TC funding is even more detrimental to regional cooperation since it does not operate within a formal integration framework.

As for country projects to advance integration, a country's priorities as enunciated by its trade authorities do not always find their way into the Bank's pipeline, perhaps because decision-makers are unaccustomed to permitting external funding of trade and integration projects. Other occasional hurdles are budget constraints in countries requesting assistance and the local counterpart requirement. Lastly, countries may be reluctant to allocate resources to integration projects if they think this might leave less money available for purely national priorities.

The Trade Sector Facility, one of the Bank's new flexible lending instruments, has been well received in the region. Though this facility has occasionally run into obstacles because of the lack of priority referred to in the previous paragraph, the demand for this funding mode is such that the current resource allocation for it will be insufficient. It also has become clear that integration processes require more sweeping adjustments than the strengthening of foreign trade institutions.

INTAL has shown that it can respond quickly to frequent urgent requests for modest integration support and has proved to be a valuable vehicle for training and information dissemination, thanks to its recognized "trademark" in integration issues.

As was noted earlier, there is little coordination of donor support for integration and trade. Furthermore, many countries, particularly the smaller ones, sometimes have difficulty identifying their needs. The Bank can bring its experience to bear to coordinate donor/recipient country relations.

The Bank has shown itself to be an active, respected opinion shaper, frequently providing guidance and helping to propel a variety of integration processes. Publications and public event organization (and participation in such events) are its chief avenues of communication in this respect. However, the Bank has not arranged consultation forums with country and regional authorities as it has done on the national scale with the high-level policy discussions known as encerronas.

The Bank's new Regional Policy Dialogue program, in which several Bank departments are involved, has helped to transmit best practices among countries and identify regional cooperation programs. The Special Integration Program has heightened the Bank's profile in integration and trade issues and made it possible to respond quickly to urgent demands for support for liberalization impact studies and information channels for civil society.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

AREAS FOR BANK ACTION



Regional integration offers scope for a whole range of actions. The wealth of lessons learned in this field should be put to service to strengthen integration processes, as discussed in the third chapter of this paper. However, the Bank should target its action strategically, giving priority to activities in which it can make the most of its comparative advantages as a regional lending institution. At the same time, priority needs to be given to actions that can substantially aid the consolidation of critical stages in integration processes and/or produce synergies across the countries' integration and cooperation agendas. The ultimate aim of support for regional integration—to spur sustainable economic growth while reducing poverty and enhancing equity along the lines of the MDG—will only be achievable if the integration rules adopted make for balanced opportunities and set the stage for eventual country convergence, and if institutions can compensate in some manner for asymmetries between and within the integration partners. Unless due heed is given in integration processes to poverty reduction and equity enhancement they may well run into political and social opposition.

The Bank's priorities take operational shape in regional and country programming exercises in which countries' needs and requests are addressed and Bank staff bring their professional judgment to bear.

In its activities to further regional integration the Bank's priority focus should be support for subregional and interregional integration processes (including North-South initiatives) which are economically relevant (not all are) and have the political support of the parties concerned. Since in LAC countries these processes pursue different integration goals and are at varying stages, political backing and the countries' development status and their other circumstances all are key considerations. With that in mind, and to provide the necessary focus for the Bank's activity, priority action areas are as follows: (A) Consolidate regional markets; (B) Promote regional infrastructure; (C) Strengthen integration institutions, and (D) Foster other RPG.

CONSOLIDATION OF REGIONAL MARKETS

'Deep integration' agendas can move forward when market access problems have largely been resolved and economic and trade interdependency can increase. The following are the main trade-support areas in which Bank actions can have a significant impact.

The Bank can help countries to research and calculate the costs and benefits of protection and of integration and trade liberalization options. Such evaluations should go beyond an analysis of the static effects of trade creation and diversion: countries also need support to assess the dynamic effects of production transformation and the distribution of benefits between and within the partner countries.

One key focus of attention is regional market consolidation, to preserve the gains achieved thus far and continue to enhance liberalization processes. The priority aim of the Bank's umbrella strategy should be to provide support to countries to devise and

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

enforce rules that will foster efficient trade and investment in the regional marketplace. So that the benefits of the major headway made in liberalizing trade in goods in the subregions can be fully captured the Bank will offer support to countries as they work to remove the plethora of nontariff barriers still in place, including the reduction of dysfunctional regulatory asymmetries.

The Bank also will offer support to countries that wish to liberalize the four basic modes of trade in services: cross-border supply (domestic consumers purchase services from a supplier in another country); commercial presence; consumption abroad, and movement of physical persons (to furnish services outside their home country). Specifically, the Bank will support assessments of alternatives and the eventual implementation of actions to facilitate and boost trade in financial services, primarily in the financial intermediation, insurance, securities, and pension spheres.

Certain intrinsically financial activities are undeniably important for goods and services transactions between individuals and legal persons in different countries. The Bank will offer assistance to countries that wish to pursue trade-relevant actions in the financial arena, principally initiatives involving payments systems and mechanisms.

Given the importance of some extraregional markets and the potential benefits of agreements to secure access to those outlets, the Bank will, on request, support countries' participation in North-South integration initiatives like the FTAA and agreements with the European Union and with Asian countries. It also will offer facilities to strengthen countries' capacity to formulate positions in multilateral forums like the WTO Doha Round, given the importance of such forums for market liberalization and their contribution to regional integration agendas. LAC countries need to bolster their negotiating capacity to be able to obtain trade-barrier reductions in the industrialized nations, see the benefits of growing global trade shared more equally and be able to include agriculture in trade negotiations.

Combining subregional integration with North-South free trade agreements can yield considerable benefits, providing more secure access to larger markets, minimizing trade diversion in the subregions, attracting foreign direct investment, spurring institutional modernization and regional cooperation, and fostering productivity increases. In the area of North-South trade relations the IDB will continue to support studies and initiatives to find ways around roadblocks in trade negotiations, for example, avenues for improving labor and environmental standards with no protectionist motives, and disciplining options for contingent protection measures.

PROMOTING REGIONAL INFRASTRUCTURE

How far integration processes can go depends in large measure on increases in trade and investment among the participating countries. However, unless the present infrastructure is augmented, countries may be unable to follow through on their market liberalization plans. 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 and environmental impacts. Consequently, the Bank should deepen its support in the following areas:

The Bank should continue supporting country infrastructure projects, building in a regional dimension and contemplating existing or potential regional projects. The benefits and costs associated with a regional thrust need to be quantified. Harmonizing and modernizing regulatory frameworks and standards is as important as physical investment. In its catalytic role the Bank should identify projects and leverage funds for infrastructure improvements from the private sector and

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

other sources. The regional perspective is vital in the transportation, telecommunications, and energy sectors particularly.

All the participants stand to benefit from transnational infrastructure projects, but the net benefits for any one country may not be commensurate with the costs. The Bank should take the lead and offer support via the IIRSA and PPP, which are addressing current issues and problems in areas such as short sea shipping, air transport, energy, communications, and border crossings. The following should be the focuses of Bank action in those and other spheres: coordination of sector regulatory standards, this being essential if physical investments are to serve their purpose; selection, evaluation and prioritization of transnational projects; design of financial structures and mechanisms for projects that can even out cost and benefit asymmetries between countries and promote explicit public-sector support (political and financial); mobilization of local and international capital markets; facilitation of private-sector participation in regional infrastructure expansion and modernization; proactive efforts to build in environmental criteria and regarding the positive local-development impact of infrastructure projects; collaboration with other regional institutions to deliver logistical, technical and financial support for collective processes; and support for consultations with civil society and the private sector and for involving those sectors.

INSTITUTION STRENGTHENING

The Bank should 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. It should continue to collaborate in strengthening national institutions that are the counterparts for integration processes, and in developing the corresponding career civil service areas. It is important that there be an institutional memory and a measure of stability in the national and regional cadres involved in regional or multilateral trade and integration initiatives. Sectors that are key focuses for institutional support, to which Bank activities can contribute significantly, are described below.

At the Country Level

The Bank will continue to support human resources training in individual countries to help develop the requisite pool of experts to manage regional and multilateral negotiation processes and implement and monitor the agreements achieved. Such training should instill a deeper understanding of the benefits and costs associated with commitments coming out of trade negotiations, to manage such undertakings in a socially efficient manner. Training in the development of interministerial coordination mechanisms and avenues for civil society consultations should be addressed as well. The private sector should be able to participate in the training programs provided its representatives help defray the costs of their participation.

Support for public management and national institution strengthening should include activities to equip such institutions to assess and propose policies to manage the adverse impacts of the free-trade transition on certain sectors, regions, or vulnerable populations. To improve integration's prospects of reducing poverty and inequality the Bank should be prepared to assist countries, on request, in developing and implementing policies to manage the free-trade transition which would equalize opportunities within and between participating countries and help them in achieving the MDG.

By way of modernization of the State programs the Bank has been supporting justice system reform and other initiatives intended to entrench the rule of law and strengthen democratic systems across the region. As the

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Bank's new State modernization strategy emphasizes, such programs must address the need for convergence between LAC countries on this front, in order to further subregional, regional, and hemispheric integration processes.

Given trade's preeminent role in integration and liberalization processes and the importance of access to funding, the Bank will support country efforts to develop and improve the workings of financial institutions and products with a view to boosting trade. Particularly in the case of SMEs, given their impact on employment and inequality and their greater difficulties to obtain effective and efficient financial intermediation in development countries.

Bank-supported programs to help improve national customs administrations need to be adapted to the multiple demands of the various agreements and a complex web of tariff preferences and rules of origin. The Bank will support customs facilitation initiatives, promoting harmonization of procedures and standards to make for greater transparency and enhance competitiveness.

As economies become more integrated the role of taxation in corporate global strategies becomes more and more important, as do differences in legislation and tax administration (structures, bases, rates, compliance, due process, and treaties); ultimately these can cause economic distortions or encourage tax evasion or avoidance. Most tax systems in the region were structured for more closed economies, with stiff effective protection at their core. Now that economies are opening up, the Bank's modernization of the State activities should include support for countries to rewrite or adjust their tax systems to make them more trade- and foreign investment-friendly and align them with international agreements, rules and practices. Tax systems should avoid distortions that leave domestic producers at a disadvantage to foreign competitors. Likewise, internal revenue systems need to make sure there will be enough resources to make up for anticipated tariff-reduction losses, to produce the balanced budgets that are so vital for macroeconomic management. Other regulatory constraints should be addressed to help attract foreign direct investment.

At the Regional Level

One important benefit of building regional institutions is that they provide a framework for competitiveness improvements. Such institutions require a small team of skilled personnel and a predictable regional budget to defray their costs. Examples of institutions warranting special attention are those in charge of dispute resolution, contingent protection, technical secretariats, and institutions that support cooperation or coordination in key areas for trade and investment, such as technical standards—particularly health and phytosanitary standards—and competition policies.

In some cases, market solidification moves can proceed amidst less uncertainty thanks to the use of common external tariffs (CETs) and customs unions. However, creating and implementing either of these options requires complicated negotiations and careful designing, particularly when there are significant differences in the partners' economic weight. Moreover, some agreements require new collective institutional frameworks for customs matters. The Bank will, on request, put instruments at the countries' service to better equip them to design, negotiate, and implement arrangements of this kind.

The Bank will help further macroeconomic policy coordination through discussion forums and study papers and development of the mechanics for incorporating a regional dimension into country authorities' macroeconomic goals. These actions will expedite the creation and exchange of homogeneous, comparable data and the harmonization of policy measures and goals among national

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

authorities and experts, and will make the countries involved more competitive. In particular, within the framework of integration processes the Bank should discourage the establishment of conflicting monetary, fiscal, or debt policies, or their sequencing, that would run counter to the member countries' shared integration goals.

The Bank will continue to fund seminars and studies to assess alternative approaches to tax policy harmonization that can help countries adjust to the needs created by heavier, freer trade and foreign investment flows in the subregions. A particular focus will be efforts to minimize the risk of "incentives wars" to attract foreign investment. Sector policy coordination to facilitate the development of production chains is another area requiring attention.

As a tool for empirical evaluations of integration processes and also as a way of deepening trade and macroeconomic coordination, it is vital that the Bank continue to help develop and maintain accessible, adequately disaggregated database systems that are cross-country consistent in key areas for integration. Priority focuses here are trade in goods, tariffs and tariff preferences, rules of origin, nontariff barriers, services trade, government procurement, foreign investment (particularly intraregional investment), macroeconomic indicators, and industry surveys.

The Bank should continue providing collective financial and technical support for FTAA negotiations and for the new FTAA Hemispheric Cooperation Program, under which national or regional action strategies are to be developed for training, implementation, and reforms to spur the free-trade transition, and a donors' forum is to be organized. The Bank also should be prepared to respond to requests involving other plurilateral North-South integration initiatives such as the Central America Free Trade Agreement with the USA (CAFTA). As for the multilateral system, the Bank should continue supporting the WTO courses.

The Bank should stand ready to support countries that wish to promote the use of collective compensation mechanisms to share the benefits of trade more evenly, fostering proactive measures to smooth potential imbalances between integrating countries. This is especially important in North-South agreements.

OTHER REGIONAL PUBLIC GOODS

As economies become more intertwined more avenues are opening up for enhanced cooperation, particularly for RPG in spheres that offer high returns to welfare, regardless of the fate of the regional agreements themselves. As a regional bank, the IDB has a natural leadership role to play in these efforts, by way of which it can maximize its impact. As it pursues this mission the Bank should help ensure balanced participation of all countries and their regions, seeking balanced outcomes. To that end it should evaluate and apply best practices in conceptualization, identification, prioritizing, sequencing, monitoring, and evaluation of regional cooperation. The core objectives of reducing poverty and inequality and achieving sustainable growth should be preeminent considerations as the Bank spearheads the generation of RPG. With those twin objectives in mind, the central action focuses are as follows.

The Bank will support the development and implementation of regional codes where such instruments would offer common benefits in areas with significant externalities (e.g., environmental, health, and phytosanitary standards). Capturing those externalities also can improve competitiveness. In some cases—environmental standards, for instance—such assistance can be channeled through technical support commissions[4] whose activities can enhance cooperation.

[4] NAFTA's Commission for Environmental Cooperation, for instance.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

The Bank should continue supporting natural resources initiatives involving watersheds, biological corridors, etc. Two priorities here are biodiversity protection and careful stewardship of natural areas and fragile ecosystems that provide environmental services. Other areas warranting attention are coordinated regional action on migration issues, technology cooperation, disease control, and natural disaster prevention and mitigation.

Considering the financial stability of a region's countries as a RPG, the Bank should support collective, consensus-based efforts to improve the quality of regulation and oversight of banks and other financial intermediaries and of other financial activities and services such as the insurance and securities industries. Likewise, it should support the coordinated creation of institutional and regulatory frameworks that will help make more, better-quality information available to private agents, thereby enhancing the region's competitiveness.

Cooperation among LAC countries is important to be able to advocate for a better international financial architecture in the pertinent forums. The Bank should maintain close relations with organizations of regulators and oversight bodies in the region and should continue to support the Regional Finance Sector Forum to expedite discussion and analysis of financial issues, with a regional perspective, among policymakers from across the region.

The Bank should continue to support projects which promote integrated development of border regions, creating legal frameworks that will facilitate cooperation and enhance coordination of socioeconomic development of communities on either side of a border and helping to remedy shared problems in areas such as the environment, migration, sanitary controls, and health, to make these regions more competitive.

The Bank should continue its support for events that bring together senior officials from across the Americas to exchange ideas, share information about best practices and explore cooperation avenues. Of particular importance are forums that further political convergence programs, such as the Quebec summit and Rio Group gatherings. As for large-scale cooperation ventures like the hemispheric process and the agreement with Europe, it is important that the Bank prioritize its support among the numerous activities requested by governments, promoting those that have quantifiable, evaluable objectives.

The Bank should offer its offices to coordinate donor and recipient countries' regional integration and cooperation activity, working closely with the subregional development banks.

Collaboration with other subregional banks and bilateral donors in the creation of RPG.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

OPTIONS FOR BANK SERVICES AND IMPLEMENTATION GUIDELINES



The Bank can bring its toolkit of financial and nonfinancial products to bear at both country and regional levels to implement the integration strategy set out here. Changes in the way these instruments are programmed and employed are being proposed in order to make optimum use of all of them. Implementation of this strategy will be closely interfaced and coordinated with other Bank institutional strategies.

FINANCIAL PRODUCTS

Regional technical cooperation (RTC). This is a key Bank instrument for supporting regional initiatives and providing incentives for innovative policy-making. As was noted in the previous chapter, the effectiveness of RTC has dropped sharply as a result of an abrupt reduction in the funds available. Since it is unlikely that funding availabilities will return to past levels, at least in the immediate future, it is important to come up with alternatives to supplement this vital instrument to further regional integration and cooperation processes. In these circumstances 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, the PPP, the FTAA, the hemispheric summit process, and EU-LAC cooperation and trade initiatives. INTAL programs also merit this mode of funding because they specialize in training, including support for WTO courses and public forums for discussion, analysis, and information sharing on integration and trade, enabling the Bank to respond nimbly to modest TC requests.

Country lending. Given the dearth of RTC funding and the importance of integration for structural reform, it is more urgent than ever to add regional integration and trade support programs to country loan pipelines. There are abundant opportunities for institutional strengthening of national counterparts and for their follow-through on regional and multilateral commitments and implementation of national trade policies and institutions.

Special lending in support of trade and integration. The Trade Sector Facility should continue to operate and be given the resources needed to meet the heavy demand associated with the requirements of bilateral, subregional, hemispheric and multilateral agreements that are being negotiated (and will continue to be negotiated), which LAC countries should be implementing in the near future. However, because this Facility does not cover all facets of the sectoral adjustment demands triggered by integration processes, it is proposed that the Bank look at the implementation of integration sector loans, contemplating in such lending an integrated package of support components including preventive and corrective actions in a limited and delineated number of target areas that need to adapt in order to seize all the opportunities that come with integration. The starting point for adoption of these instruments could be a pilot program, taking care not to go into reforms envisaged in other programs already under way. The Bank's operational departments should head up this process, with INT, RES and SDS collaborating as needed.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Regional infrastructure lending. The Bank should explore the possibility of increasing incentives for regional infrastructure investment. Bank actions (including PRI activities) designed to facilitate private sector participation in integration infrastructure, particularly through concession arrangements, should be stepped up.

Multilateral Investment Fund (MIF). The MIF should play a more prominent role in supporting subregional, regional, interregional and multilateral initiatives. Greater use should be made of its trade and investment cluster, channeling this support through subregionally organized programs where there is a measure of similarity between problems, capacities, interests and challenges. Publicity about this cluster also can be improved to better explain all the activities that are eligible. The MIF can assist the private sector and labor unions to understand the obligations emanating from integration and trade agreements and help those sectors make governments aware of their interests and of the opportunities the negotiations afford. The MIF also can broaden its assistance to help prepare companies (especially small and mid-sized businesses) and labor markets for the adjustments, behavior changes and competitiveness improvements demanded by the sweeping liberalization processes born of North-South integration and the WTO agreements.

NONFINANCIAL PRODUCTS

The Bank has a wealth of experience and good credibility in the integration field, which it should place at the service of countries in the region.

The Regional Policy Dialogue has proven to be a valuable forum for senior policymakers to reflect, exchange views and explore cooperation avenues. Its action focuses should reflect country demands, manifested through their participation.

Policy-oriented research, publications, conferences and seminars are important vehicles whereby the Bank can foster and help chart integration and trade processes. One noteworthy development is the creation of research networks like REDINT and Euro-Latin Research Network for Integration and Trade.

The Special Integration Initiative with its three components (occasional policy papers with a wide circulation, written by eminent experts; support for trade liberalization impact assessments, and public education forums on integration and globalization) has had an appreciable impact on integration processes. Given the challenges that await LAC countries in the coming years, this initiative should be extended until at least 2004 to be able to satisfy the heavy demand that can be expected for upcoming negotiations.

The Bank should organize annual meetings of its experts with country and regional authorities from each subregion to discuss advances, issues, and the future direction of their integration schemes.

The Bank should continue to use its good offices to organize countries and donors for structured evaluation processes to assess trade capacity constraints, and donor coordination and information-sharing mechanisms in order to supply technical assistance needs more effectively. Examples of focuses for Bank involvement here are programs supporting the Central America Free Trade Area and collaborative efforts with the WTO secretariat.

Collaboration with the staff and programs of the subregional banks needs to be intensified. In the case of the Organization of Eastern Caribbean States, collaboration with the Caribbean Development Bank could be stepped up, disseminating studies and other Bank materials in these countries.

IMPLEMENTATION ACTIONS

Regional programming papers (RPs). As discussed earlier, the Bank should put its

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

complete menu of financial and nonfinancial products at the service of regional integration and cooperation. The RP—the Bank's tool to help allocate these products—will continue to be coordinated by INT, the Bank department specializing in integration and trade, and will be co-authored by the respective Regional Operations Department. Representatives of SDS, the MIF, and other departments as needed will be members of the teams in charge of RPs.

The current RP practice of producing a strategy for each of the four major subregional agreements every four years will continue. These strategies will be updated by way of annual executive memoranda sent to the Board for information. The Bank would address the dynamic of nonmember countries in a subregion by incorporating them into the RP that is closest to their commercial or geopolitical interests. Thematic RPs (not confining their analysis to the geographic boundaries of a subregion) also will be produced as needed.

To better interface the Bank's programming processes and tap the full range of opportunities that a regional perspective affords, the RP should go beyond its traditional regional-action focus to include country chapters with a regional dimension. These chapters, prepared in concert with the Regional Operations Departments, will complement the RP's traditional regional approach and be inputs for country strategy development. As in the past, INT will help develop trade- and integration-relevant components of country strategies and will provide technical support to the Regional Operations Departments for the preparation and execution of projects with integration and trade content.

INT should provide the regional perspective currently lacking in country project preparation, participating as a Loan Committee member as it deems pertinent. To strengthen this regional focus the Regional Operations Departments should establish focal points for collaboration with INT in regional programming. INT, for its part, will request to its staff responsible for each one of the regional programming exercises to support Regional Operations Departments with country programming and projects that have a trade and integration dimension.

Action Plan

The proposed action plan for implementing the integration strategy can be summarized as follows.

Financial Products

- Prioritize RTC use for programs to support large-scale plurilateral, multipartner integration and cooperation initiatives such as the IIRSA, PPP, FTAA, the hemispheric summits process, and EU-LAC cooperation and trade initiatives, as well as INTAL activities and programs.
- Encourage countries to request more country loans for programs to support regional integration and trade.
- Increase the resources of the Trade Sector Facility to meet the demand, which will undoubtedly grow given the requirements of agreements currently on the table and others to be negotiated in future, and which LAC countries should be implementing in the near term.
- Explore the implementation of integration sector lending, contemplating an integrated set of support components including preventive and corrective actions in areas in need of adjustment in order to fully tap the opportunities the integration process affords.
- Given the externalities that are there to be captured the Bank should look into ways of enhancing its incentives for regional infrastructure investment.
- Improve the MIF's trade and investment cluster, which can be channeled via subregionally organized programs since

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

there is a measure of similarity between problems, capacities, interests and challenges.
- Use the MIF to help the private sector and labor unions understand the obligations emanating from integration and trade initiatives and to prepare companies (especially small and mid-sized businesses) and labor markets for the adjustments, behavior changes and demands for competitiveness improvements they will have to contend with as economies open up to the global marketplace.

Nonfinancial Products

- Continue supporting the Regional Policy Dialogue, which has proved to be a valuable forum for senior policymakers to share ideas and knowledge and explore cooperation avenues.
- Promote policy-oriented research, publications, conferences and seminars to foster and help chart integration and trade processes.
- Extend the Special Integration Initiative to at least 2004 to address the heavy demands that forthcoming negotiations will entail.
- Organize annual meetings of national and regional experts and officials from each subregion to discuss progress, issues, and the future course of their integration schemes, including the issue of labor mobility.
- Organize structured evaluations of trade capacity constraints and coordinate donor exchanges of information to respond more effectively to technical-assistance needs.
- Collaborate more closely with subregional banks' staff and programs.

The Project Cycle

- Produce regional programming papers (RPs) co-authored by the respective Regional Operations Department and with support from SDS and MIF representatives and other departments as needed.
- As is the current practice, produce a strategy for each of the four major subregional agreements every four years. Update the strategies by way of annual executive memoranda sent to the Board for information.
- As necessary, prepare thematic RPs, not limiting their analysis to any one subregion's geographic boundaries.
- In the RP include country chapters with a regional perspective, prepared in concert with the Regional Operations Departments.
- With support from INT, develop trade- and integration-relevant components of country strategies.
- Promote a regional focus in country-project preparation, with INT participating as a Loan Committee member.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

MONITORING, EVALUATION, AND PERFORMANCE INDICATORS



This chapter proposes indicators that the Bank can use to gauge the achievement of objectives by virtue of the strategy's implementation. In principle, the strategy's application can be tracked and evaluated using indicators to measure outputs, outcomes, and impact. The former have more to do with direct Bank actions, in which the Bank can have a more rapid, obvious effect; the latter measure general welfare changes, which are affected by many other, more determinant variables. INT will coordinate its work with OVE to develop more specific indicators for the different support actions related to trade and integration proposed in this strategy. Those departments, together with SDS, will jointly develop other specific indicators for actions to support the creation of other RPG.

Output indicators: The following are the proposed indicators to measure progress in instituting the changes suggested by this strategy: number and volume of loan approvals relating to regional integration; number and volume of loan approvals under the Trade Sector Facility; number of country operations containing a regional component or thrust; number of TC operations supporting regional integration; number of nonfinancial products deployed in the integration field; number of evaluations and sector performance reviews. By 2004 there is to be a section on regional integration in the Bank's country strategies. The Bank also should refine its procedure for counting regional content in its funding operations.

Outcome indicators: Evaluating the Bank's integration support instruments will help redirect them to make this support more efficient and effective. These will be the typical indicators used in strategy implementation tracking instruments, i.e., evaluations of projects involving regional integration—by reference to project performance monitoring reports (PPMRs), reports from the Project Alert Identification System (PAIS), and project completion reports (PCRs)—and OVE evaluations of the various programming processes and their implementation, looking at their contribution to regional integration.

Impact indicators: Evaluating the impact of integration is no easy task, whether for the Bank or the academic community, and much hard work remains to be done in this field. Referencing the information available, calculations of the strategy's country-level effects could include indicators developed as part of the initiative to enhance the development effectiveness of Bank activities. Other indicators that could be used to evaluate Bank-supported integration processes in general are: lowering of trade barriers; composition, distribution and levels of trade and intraregional trade and commercial interdependence; participation of smaller economies; attraction of foreign investment, and indicators of macroeconomic convergence.

This strategy will be evaluated three years after its approval.

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub



ANNEX

Areas of Action for the Bank and their Relation to the Sustainable Economic Growth and Poverty Reduction Strategies

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
A. Consolidation of Regional Markets	**Increased economic growth through increased trade from market expansion**	**Help ensure that the poor share in the benefits of regional trade**
Objective: Help advance the integration agenda by expanding market access, heightening economic and commercial interdependency.	*Objective:* Achieve sustainable increases in trade and economic activity.	*Objective:* Increase opportunities for economic inclusion.
• Evaluation of integration's costs and benefits	• Impact studies of trade agreements in different scenarios.	• Evaluation of agreements' impacts on the most disadvantaged sectors, regions, and populations.
• Consolidation of the regional market, dismantling barriers and promoting efficient customs unions	• Removal of tariff and non tariff barriers, including smoothing of regulatory asymmetries.	• Give the poor greater access to goods and services in the regional market.
• Strengthening of financial services integration processes	• Facilitate efficient trade in financial services, especially in the areas of financial intermediation, insurance, securities, and pensions.	• Enhance marginal populations' access to services.
• Opening up of extraregional markets and softening of protectionist obstacles	• Support for multilateral negotiations and the reduction of barriers to extra regional integration.	• Increase in employment opportunities.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
B. Promotion of Regional Infrastructure	**Increase infrastructure as a way of boosting trade**	**Infrastructure investment in less developed areas**
Objective: Lessen regional and national infrastructure constraints that are holding back integration.	*Objective:* Remedy infrastructure limitations that could impede the trade flows needed for economic growth.	*Objective:* Have regional infrastructure expansion also benefit the poorest regions and marginalized groups.
• National infrastructure expansion with a regional development and social sustainability perspective	• Support for country infrastructure projects that promote development within a regional integration framework	• Support for infrastructure projects that benefit marginalized populations
• Intersubregional and hemispheric cooperation for regional infrastructure	• Support for creation of development hubs by virtue of regional infrastructure (e.g. IIRSA and PPP)	• Promotion of development hubs in poor areas

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
C. Institution Strengthening	**Strengthening the institutional apparatus for growth-driving integration agreements**	**Institutions equipped for negotiating and implementing balanced trade agreements that address economic-inclusion concerns**
Objective: Improve regional and national institutions and rules to help advance integration.	*Objective:* Create the requisite rules and institutions for workable, economically advantageous integration agreements.	*Objective:* Create frameworks that enable balanced integration, providing benefits for the poorest regions and marginalized groups.
• Capacity to negotiate and implement agreements, and to ensure adequate transition to free trade	• Strengthen institutions that implement and monitor agreements and manage the adverse impacts of the free-trade transition; training of negotiators; and creation of effective dispute resolution mechanisms.	• Build negotiating capacity that duly addresses social equity concerns, minimizes adverse impacts and adopts measures to balance trade effects.
• Financial institutions and instruments to promote trade	• Export credit agencies and facilities.	• Priority support for SMEs.
• Adequate customs and tax systems adapted for trade and foreign investment needs	• Modernization of procedures, harmonization of standards, time and transaction-cost reductions and adaptation of tax systems to enhance competitiveness and the investment climate.	• Ensuring that tax reforms do not harm the poor.
• Strengthening and rationalization of integration institutions	• Support for technical secretariats of integration agreements and their national counterpart bodies.	• Development of institutions for societal consensus-building that give a voice to the most disadvantaged sectors and protect their interests.
• Coordination of macro, tax and sector policies	• Exchange of information and harmonization of policy measures among the countries.	• Increased income stability and employment opportunities for the poor through policy coordination at the regional level.
• Collection, evaluation and dissemination of trade and integration data and information	• Expedite decision-making so viable, advantageous agreements can be achieved.	• Fostering of knowledge for decision-making that will benefit the poor and the vulnerable.
• North-South integration processes	• Collective support for initiatives like the FTAA and its Hemispheric Cooperation Program.	• Promoting creation of mechanisms to protect the poorest countries and regions.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
D. Other Regional Public Goods	**Cooperation for the creation of regional public goods**	**Promote regional cooperation in public goods that will benefit the poor**
Objective: Maximize cooperation among LAC countries to produce public goods, independently of trade integration agreements.	*Objective:* Create regional public goods in areas that can spur economic activity and capture externalities.	*Objective:* Pursue actions whereby regional public goods can reduce poverty and inequality.
• Codes, common regulations, or consultation mechanisms in spheres involving regional public goods such as the environment and health	• Support for adoption of regional codes and rules that yield common benefits.	• Ensure that regional codes and rules benefit all the countries and improve the lives of the poorest and most vulnerable
• Protect biodiversity through regional actions	• Management of natural areas and fragile eco-systems at the regional level to achieve sustainable growth.	• Management of natural areas and fragile ecosystems the deterioration of the poor's natural capital.
• Integrated development of border zones	• Foster cooperation for the socioeconomic development of border zones communities.	• Support for border area development policies in depressed regions, benefiting the poor and the excluded.
• Fostering of financial stability as a regional public good	• Achieve of consensus-based improvements in financial regulation and supervision.	• Protection of savings and supply of credit, particularly for the poorest and most vulnerable.
• Dialogues for senior level officials	• High-level horizontal cooperation to promote economic development institutions and policies.	• Placement of poverty and inequality reduction issues on agendas.
• Other regional public goods	• Coordination of recipient and donor countries for regional public goods that support sustainable economic growth.	• Support for negotiation forums, mobilization of funding, and other mechanisms for regional public goods that can benefit the most disadvantaged populations.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This page intentionally left blank

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ENVIRONMENT

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

This Strategy Document has been prepared by the team composed of: Ricardo Quiroga (Team Leader), David Wilk, Joseph Milewski, Silvia Ortiz, Felipe Albertani, María Eugenia Kyburz (SDS/ENV), Gil Nolet (PRE/PCY), and Luis García (Consultant), under the supervision of Antonio Vives (SDS/PEF) and Walter Arensberg (SDS/ENV). This Strategy is part of the group of Strategies being developed in the context of the implementation of the Bank's Institutional Strategy, processed by an Inter-Departmental Working Group led by Carlos M. Jarque, Manager of SDS. Specific contributions have been provided by Janine Ferretti, SDS/ENV and by members of the Technical Advisory Group integrated by: Héctor Malarín, María Claudia Perazza (EN1); Michele Lemay, Jose Rente Nascimento (EN2); Eduardo Figueroa, Fernando Bretas (EN3); Carlos Perafán, SDS/IND; Ruben Echeverría, SDS/RUR; Luis Fierro, SDS/SDS; Ernesto Castagnino, SDS/SGC; Michael Toman, Diego Rodríguez, Kari Keipi, Carlos López Ocaña, SDS/ENV; Raúl Tuazón, RE1, Daniel Shepherd, MIF; Robert Montgomery, PRI; Marc Dourojeanni, COF/BR; Steven Stone, COF/EC; Rodrigo Coloane, COF/PN; Evan Stephen Cayetano, COF/JA; Sergio Mora, COF/RD; and Tamara Belt (LRN). The preparation of this document has benefited from broad internal and external consultations, including direct regional and extra-regional consultations with the governments of the borrowing and nonborrowing countries, representatives of civil society, multilateral agencies, specialized international cooperation agencies, and NGOs. Regional consultations were held in Brazil, Ecuador, Jamaica and Panama. The consultation in Costa Rica was part of a general consultation process on other Bank strategies for priority sectors. Extra-regional consultations were held inWashington, D.C. and France.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

OBJECTIVE



INTRODUCTION

The Board of Executive Directors approved the recommendations set forth in the document *Renewing the Commitment to Development: Report of the Working Group on the Institutional Strategy* (GN–2077–1), for the purpose of improving the Bank's effectiveness in carrying out its institutional mandates. In this context, on January 23, 2002, the Board of Executive Directors approved the document *Review of Sector Strategies, Policies and Guidelines* (GN–2077–15), and directed that a new set of strategies be prepared for the two fundamental objectives of the Institutional Strategy (*Poverty Reduction and Promotion of Social Equity, and Sustainable Economic Growth*) and for its four priority areas (*Modernization of the State, Competitiveness, Social Development, and Regional Integration*). In addition, the preparation of a cross-cutting Environment Strategy was recommended in order to fully internalize environmental sustainability as an underlying goal within the context of the Bank's Institutional Strategy.

The proposed Environment Strategy builds upon more than two decades of Bank experience and contributions to advance environmental management in the region, which formally began with the approval of the Bank's Environmental Policy in 1979. The Environment Strategy sets forth guiding principles and general priority areas of action that the Bank would promote through its financial and nonfinancial instruments. In particular, environmental governance and the development of policy frameworks that create the right set of incentives for environmental management are identified as the main areas in which the Bank should focus its attention. The Strategy also identifies areas of support that are consistent with fostering the objectives of the Institutional Strategy and its corresponding priority areas. In addition, the Strategy proposes specific actions for improving overall environmental performance in terms of Bank internal work and procedures, linked to the cycle of programming, design, and implementation.

OBJECTIVES AND JUSTIFICATION

The Bank's Environment Strategy is a guiding instrument whose fundamental objective is to attain greater effectiveness in the support that the Bank offers each of the borrower countries of Latin America and the Caribbean in terms of achieving their sustainable development goals. The Strategy facilitates the Bank's dialogue with governments, civil society, and the private sector in the context of the Bank's financial and nonfinancial portfolio. The specific objectives of the Environment Strategy are: (i) to set an overall framework for Bank action in tune with new development paradigms and current challenge and opportunities; (ii) to operationalize the principles of the Bank's Institutional Strategy and to fully internalize environmental sustainability as an underlying goal linked to its overarching objectives and priority areas; and (iii) to identify a set of guiding principles and priority actions to make Bank's internal work and procedures more effective.

In this Strategy the word "environment" is defined in its broad sense, which includes the

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

physical environment (geophysical), the biological environment (biotic), and the human environment (anthropic). Accordingly, environmental management is also a broad concept that encompasses natural resources as well as the quality of the physical environment and its interrelations with society and human behavior. Hence, the Environment Strategy applies to all sectors of Bank financing, seeking to mainstream the environmental dimension in each case. In this way, the environmental dimension is presented on a cross-cutting basis, and not as a separate sector. This new focus will allow the Bank to become more effective in addressing generally the goals of poverty reduction and sustainable economic growth.

The scope of the Environment Strategy involves the entire IDB Group, i.e. the Inter-American Development Bank (IDB) and its instruments for supporting public and private investment; and the Multilateral Investment Fund (MIF). The strategy also contributes to establish coordination linkages with private investment initiatives under the Inter-American Investment Corporation.

Given the challenges for sustainable development that the region faces and the broad array of issues that need to be addressed, having an Environment Strategy to orient and focus the Bank's work is amply justified. With regard to environmental management, the Bank has operated mainly on the basis of the Bank's 1979 Environment Policy (GP–73–3), and the mandates of the Eighth Replenishment of Capital (1994). In this framework, procedures for environmental and social assessment, and several strategy documents for priority areas (e.g., water resources, coastal resources, energy, and rural poverty reduction) have been prepared, as well as several, guidelines, and good practices papers that have supported Bank's activities in several areas such as forestry, biodiversity, and watershed management. While this context enabled the Bank to make progress on environment and natural resource management, the Bank requires a strategic approach that is more focused and integrated; will contribute to work towards sustainable development objectives that can be measured and evaluated; responds to new challenges and realities; and addresses clients' needs more effectively.

CONCEPTUAL FRAMEWORK FOR FORMULATING THE STRATEGY

The Environment Strategy is based on the recognition that environmental quality and the natural resource base constitute the natural capital that sustains economic growth and competitiveness in the long run, and factors that help reduce poverty and improve social well being. Recognizing that the Latin American and Caribbean nations have stated their vision for sustainable development in Summits and official world and regional events, the Bank's Environment Strategy will seek to help countries reach that vision cost-effectively in the shortest possible term.

The historical context of the principles of sustainable development in Latin America and the Caribbean have been shaped by the 1992 Rio Declaration and Agenda 21; the Santa Cruz Summit on Sustainable Development (1996); the 2000 Millennium Summit and the Millennium Development Goals; the Monterrey Conference on Development Financing; and most recently the Johannesburg World Summit on Sustainable Development (2002). In this context, most countries have taken significant steps to address environmental issues and have signed a series of international agreements and protocols, including, among others, the Biodiversity Convention and the Biosafety Protocol; the Forest Declaration; the Desertification Convention; the Climate Change Convention and the Kyoto Protocol. The Bank's Strategy will be an important tool to support countries in complying with those international environmental agreements.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

A major milestone for fully incorporating the environmental dimension in the Bank is the Rio Declaration and the Agenda 21 principles, which are fully reflected in the *mandates of the Bank's Eighth Replenishment of Capital*. The environmental framework of the Eighth Replenishment, on the basis of which the Bank operates, stated the following environmental priority areas: (a) strengthening the environmental, legal and regulatory framework; (b) strengthening environmental institutions; (c) improving the environmental quality of Bank-financed operations; (d) the conservation and efficient use of energy in the Bank's projects; (e) improving the urban environment; (f) management of natural resources (in all their forms) and protecting biodiversity; (g) giving effective attention to resettlement problems; (h) developing environmental information; and (i) supporting environmental education and training.

The Johannesburg Summit of 2002 reaffirms the principles of the 1992 Rio Declaration while also recognizing the integration of the three components of sustainable development—economic growth, social development, and environmental protection—as three independent yet mutually-reinforcing pillars. The Summit also highlighted the need to fight poverty, and the importance of governance, including public and private alliances as a way to overcome financial and institutional obstacles in fighting poverty and environmental degradation. In this context, participatory processes, local empowerment, and respect for cultural and ethnic values are becoming increasingly important. The Declaration of Johannesburg also reaffirms the need to attain specific goals in critical areas that affect the health and quality of life of millions of people. It invokes as a principle of sustainability the use of renewable energy and the entry into force of the Kyoto Protocol. The Declaration of Johannesburg further recognizes the importance of addressing trade and the impacts of subsidies and distortions in the real prices of tradable goods.

The principles of the Johannesburg Summit, as well as the agreements at the Monterrey Conference (2002) and the 2000 Millennium Summit and the Millennium Development Goals, seek effective performance-based development, which implies going beyond declarations towards effectively attaining measurable goals and targets overtime. The IDB and the other major regional development banks have jointly declared their commitment and support to these principles.

From the Bank's perspective, while the mandates of the Bank's Eighth Replenishment have constituted a sound framework for guiding actions and programs to support sustainable development, these actions could be considered a first phase, acknowledging that developing effective environmental management is a long-term process and that attaining the vision set forth in the 1992 Rio Declaration and recently in Johannesburg (2002) is an unfinished task. Therefore, the Environment Strategy serves to reposition Bank tools and actions for greater effectiveness in supporting the sustainable development objectives of its borrowing member countries.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



DIAGNOSIS

THE DEVELOPMENT OF ENVIRONMENTAL AND NATURAL RESOURCES MANAGEMENT IN LATIN AMERICA AND THE CARIBBEAN

Effective environmental and natural resources management is recognized as one of the key areas to encourage sustainable development in Latin America and the Caribbean, and one that requires greater attention. The natural wealth and relative abundance of the region's different ecosystems is an important base for the region's economic development and overall well being. The long-term sustainability of this base will largely depend on the capacities developed by diverse stakeholders in the public, private, and civil society realms to protect the quality and availability of the natural resource base and the environmental services provided by the ecosystems. Relative to other regions of the world, it is well documented that the Latin American and Caribbean region is well endowed in terms of its natural resource base and environmental attributes, which, if properly managed, constitute the basis for competitiveness, sustainable economic growth, poverty reduction and social development. The region continues to intensively rely on the services provided by its forest, coastal and marine resources, biodiversity, agricultural soils, and water resources. However, these services, which are basic and essential sources for any economic activity required to meet social needs and economic growth, are also fragile and in apparent deterioration in the region, as will be explained later.

The recognition that natural resources and their environmental services are key components in the equations of economic growth and social development and poverty reduction is manifested by the fact that throughout the last decade, the countries of the region, within a democratic framework, have established institutions, laws, policies, and programs to explicitly address the environmental dimension of development. In addition, significant financial resources have been channeled, mainly from nonreimbursable grants and loans from multilateral banks and bilateral donors to specific environmental programs in the region.

Notwithstanding the interest in the environment in recent years, environmental management in the region is evolving in a generalized framework of weak and underfunded institutions that have developed very unevenly. Many of the environmental institutions have been established by laws that assign them major responsibilities, yet they do not have the technical or financial resources they need to adequately fulfill their most basic mandates. In some cases, these institutions have the lowest budget allocations of any public-sector agency and depend mainly on international grants. To a large extent, these grant resources reflect priorities of the donor agencies and may deflect the attention of recipient institutions from their basic responsibilities.

One of the major institutional challenges for environmental management has been the tendency to regard the environment as a sector and not as a crosscutting dimension with shared responsibilities at different levels of policy decision making. This limits the capacity of environmental institutions, broadly defined, to step into national dia-

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

logues on fiscal and economic policy, and to be constructive participants in discussions on sector reform, integration, foreign trade, and other significant topics in development. Furthermore, environmental management is affected by cross-cutting factors that have an impact on the quality and efficiency of public management and governance in general. These factors include respect for the rule of law, citizen participation, transparency, and the processes of effective decentralization, among others. While it is important to acknowledge the advances in the region with respect to the environment, mainly in terms of developing a greater awareness of the issue, it should be noted that this is just the beginning of a process that will take many years to mature.

THE CURRENT STATUS OF THE ENVIRONMENT AND NATURAL RESOURCES

A description of the environment and natural resources in Latin America and the Caribbean can be presented in terms of opportunities and benefits, as well as in terms of the challenges and problems that the region faces. The context of opportunities and benefits is addressed in the framework of the priority areas of Bank support and the links between environment and sustainable economic growth and poverty reduction, discussed in the fourth section and Annex 1. This section emphasizes the challenges and problems that the region faces, because these problems currently affect the livelihood of millions of people and affect the economic performance of the region. Negative environmental trends are observed throughout the region, which are to a large extent the result of long historical patterns of growth obtained in part through nonsustainable consumption of natural resources.

The region, with a population of 523 million (2001), and a population growth rate greater than the world average (1.6 percent compared to 1.4 percent during the period 1990–2001) experiences mounting pressures on natural resources.[1] Trend indicators point to severe environmental degradation and the depreciation of natural capital, in all its forms, which in turn is manifested in poorer health, declines in productivity and income, physical vulnerability and diminished quality of life. Recent studies by the World Bank on the genuine savings rate in national accounts, which explicitly incorporates the depletion of natural resources and environmental damage caused by pollution in National Income Accounts, show that these rates are lower for the Latin American region than for any other region of the world except Africa. In terms of genuine savings rates, four countries of the region have negative net rates, which indicates that net capital formation, required for sustainable economic growth, may be compromised.

The major environmental challenges facing the region have been extensively documented in various regional sources.[2] Such sources reveal that, although the region has channeled considerable efforts to diminish environmental pressures, the action of governments, the private sector, and civil society have not yet sufficed to mitigate the negative impacts of development and reverse the process of environmental degradation. This can be observed in the evolution of the main environmental indicators, as described below.

---

[1] The World Bank, World Development Report 2003. The World Bank.

[2] Some of the general references include: UNEP/GRID, Global Resource Information Database, 2000; UNEP, Geo: Latin America and the Caribbean Environment Outlook 2000, 2000; WRI, UNEP, UNDP, and World Bank, World Resources 1998-1999: A Guide to the Global Environment, 1998; World Bank, 2000: World Development Indicators CD-ROM; WRI, Environmental indicators on selected topics in Latin America and the Caribbean, 2002; WRI, Earthtrends, 2002.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Forest resources, soil, and biodiversity. The region is experiencing continuing deforestation, soil degradation, and loss of biodiversity. It is estimated that in only one decade (the 1990s), the region lost some 4.7 million hectares of forest per year, with the greatest losses in Brazil (2.3 million hectares per year) and the highest annual deforestation rates in Nicaragua (3.0 percent) and El Salvador (4.6 percent).[3] The destruction of forests and the process of converting land to agricultural and urban uses have contributed to worsening soil erosion, loss of biodiversity and genetic resources, and a growing number of endangered species. In the face of these problems, responses have been forthcoming from national authorities, creating institutions and mechanisms geared to control and conservation of resources, such as designating protected natural areas and biological corridors. Nonetheless, the effective management of protected areas continues to pose a challenge, and one that should be addressed on a priority basis, as such areas lack institutional, technical, and financial support.

Energy resources and the environment. Driven by the fuel needs of transportation, industry, trade, and households, production and consumption of energy in the region experienced a rapid growth rate during the 1990s, which put additional burdens on the environment. The environmental impacts of fossil fuels consumption by the transportation sector are especially important. This sector consumes over 32 percent of primary energy and 55 percent of oil derivatives in the region. Transportation is the major culprit behind the rapid deterioration of air quality experienced in the large cities of the region (PM_{10}, CO, NOx, and SO_2) and is responsible for 36 percent of greenhouse gas emissions. While penetration of clean natural gas to meet final energy demands (other than electricity) has been significant in the region and it has become the fuel of choice in electricity, comparative advantages have remained low for alternative energy sources (solar, wind, and others). The power sector contributed only about 14 percent of Latin America and Caribbean CO_2 emissions at the end of last century. This was lower than in other regions because of the large hydroelectric component (68 percent) and the growing share of natural gas used in the new generation of efficient gas turbines. As for the use of energy by the production sectors, there has been an increase in the consumption of gasoline and diesel in the transportation sector, and of diesel in industry, which in the 1990s generated an increase of more than 50 percent in CO_2 emissions. In rural areas, the use of fuelwood in isolated rural sectors still persists in many countries of the region. The impact on deforestation and indoor pollution derived from such combustion is significant in those countries.

Water resources. Water availability and water quality issues are among the main concerns from a social and environmental perspective, which makes it necessary to search for integrated approaches to water resources management. The region faces increasing limitations on water supply, with 15 percent of the population (76 million people) lacking any access to safe water; in rural areas this figure reaches 30 percent.[4] Of the urban and rural households with water connection, 60 percent do not have continuous water service. In terms of wastewater service, less than half of the population is connected to conventional sewage lines, and one third of the population relies on individual "*in situ*" waste collection systems

[3] Food and Agriculture Organization of the United Nations. 2000. *Forest Resources Assessment.* Website: http://www.fao.org/forestry/fo/fra/index.jsp

[4] Informe regional sobre la evaluación 2000 en la Región de las Américas. Agua potable y saneamiento: estado actual y perspectivas. Pan American Health Organization (PAHO).

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

(latrines and septic tanks).[5] Disposal of raw wastewater effluents continues to be a critical problem in the region. Only 14 percent of the collected sewage effluents in the region are treated; only 4 percent of the total municipal and industrial effluents generated in Central America undergo some form of treatment.[6] Poor water and sanitation services have proved to be a direct cause of deteriorating health conditions in the region, and a major cause of environmentally induced diseases such as gastrointestinal infections, premature mortality especially among infants, and years of life lost as a result of illness in the adult population.[7] In most cases, the water problem in the region can be traced to lack of an adequate legal, institutional, and regulatory framework, gross price distortions, and subsidized services that benefit the better off segment of societies to the detriment of the poor.

Coastal-marine resources. Latin America and the Caribbean have large extensions of coastline, estuaries and other coastal ecosystems, as well as continental shelf and marine resources that offer extensive opportunities for developing sectors such as tourism, aquaculture, fishing, and maritime transportation in the region. Although coastal areas still support 60 of the region's 77 largest cities and nearly 75 percent of its inhabitants[8], many coastal and maritime zones of the region have experienced diminished productivity and quality due to accelerated rates of development, conflicts among sectors, and an inadequate response on the part of the various actors involved. The destruction of mangroves and coral reefs, the loss of fishing resources due to overfishing, coastal pollution due to polluting effluents and solid waste, and high risks of flooding and erosion are examples of the high impact caused by unregulated human activity in coastal and marine areas.

Urban air pollution. With rapid urbanization, air pollution levels in major urban centers in Latin America have become acute. Air pollutants from vehicular and industrial sources have increased significantly, including carbon monoxide, particulates (including fine particulate matter –PM_{10}), ozone, sulphur oxides, nitrogen oxides, lead, and airborne toxics. The transport sector is responsible for 75 to 90 percent of all CO and NOx emissions, and for close to 50 percent of PM10 and more than 35 percent of volatile organic compounds (VOCs) in such cities as Mexico City, Santiago de Chile and Sao Paulo.[9] Major causes of transport pollution include a growing yet aging vehicle fleet, low quality of gasoline, lack of emission controls, congestion on the roadways, and deficient public transportation. Industrial activities contribute to growing SOx emissions and other pollutants, as a result of continuing reliance on high-polluting fuels and lack of emission controls in industry. The health impacts of high air pollution levels are staggering. More than 100 million people in the region are exposed to levels of urban air pollutants that exceed WHO recommended ambient air quality standards, and more than 100,000 deaths occur from exposure to vehicular emissions alone each year.[10] Acute respiratory infections are the third leading cause of death in Latin America, and more than half of these deaths

---

[5] Los desafíos de la seguridad hídrica en las Américas. Foro Agua para las Américas en el Siglo XXI. Mexico, October 8–11, 2002 (SEMARNAT-CNA).

[6] Global Water Partnership, Centroamérica. Grupo Consultivo del Agua. Agua-Tiempo-Clima Bulletin, Volume 1, No. 1, July-August, 2002.

[7] Meeting of the Health and Environment Ministers of the Americas, Ottawa, March 4–5, 2002 (PAHO).

[8] Environmental Indicators on Selected Issues for Latin America. IDB/World Resources Institute, February 2002.

[9] Clean Air Initiative in Latin American Cities. Progress Report 2001. The World Bank, June 2001.

[10] *Regional Plan on Urban Air Quality and Health 2000–2009.* PAHO OPS/CEPIS/99.21(AIRE), PAHO, Washington, DC, 2000.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

occur in children under five years of age[11]. It is estimated that the health burden of air pollution in our region over the next two decades will amount to an average of 140,000 premature deaths per year.[12]

Deficient solid waste management. The collection and disposal of solid waste is a critical problem in Latin America and the Caribbean. In several public opinion surveys carried out in IDB projects, solid waste often appears as the first problem that the population would like to see resolved. As the population grows and the size of urban centers increases, the solid waste problem increases in magnitude and complexity. Most countries, with the exception of Chile, still have below 85 percent collection coverage in urban areas, with some still below 30 percent (Honduras and Haiti). Very few cities have adequate sanitary landfill operations, and many cities still dispose of their waste in an uncontrolled fashion.[13] Vast natural areas are affected by uncontrolled waste disposal, affecting entire watersheds, streams and coastal areas. The environmental and social effects of deficient solid waste management in the region are numerous, ranging from severe soil and water pollution from inadequate disposal, to severe health impacts on poor communities involved in informal waste collection and recycling at dump sites, where children and women are among the most affected by these activities.

Threat of and vulnerability to natural phenomena. The region is constantly threatened by natural phenomena (earthquakes, floods, fires, tropical storms and hurricanes, drought, and landslides) that cause large-scale economic and environmental damage. The region experienced a total of 40.7 disasters/year between 1990 and 1998, with total direct and indirect economic losses that amount to close to US$20 billion.[14] The earthquakes that have besieged the region, especially those originating along the tectonic plates of the Pacific coast, have had devastating effects. The hurricanes that have lashed the Caribbean and Central America (Gilbert, Georges, Mitch), and the floods that the region suffers constantly, have inflicted large-scale loss of life, left thousands without a home, and caused huge material losses. Hurricane Mitch caused, in Honduras alone, the death of close to 15,000 people, and outbreaks of multiple infections and vector-borne diseases such as cholera, malaria, and dengue, among others.[15] When natural disasters occur, the poor segments of the population are the most affected due to their precarious living conditions and vulnerability. Unfortunately, most countries still lack appropriate prevention mechanisms and rational land use planning and environmental codes do not exist or are not enforced.

Climate change and global environmental threats. Vulnerability phenomena linked to global warming, such as changes in precipitation levels, rising sea levels, poses a potential threat to many countries in the region. As stated in the Framework Convention on Climate Change and the Kyoto Protocol, developed countries are to undertake initial efforts to reduce emissions and provide resources that facilitate developing countries to face the challenges of adaptation to these

---

[11] Meeting of the Health and Environment Ministers of the Americas. Background Briefing Paper 2: Clean Air. Ottawa, March 4-5, 2002 (PAHO).

[12] Health and Environment, World Bank, Environmental Strategy Papers Series No. 1. Lvovsky, K.. October, 2001.

[13] Diagnóstico de la situación del manejo de residuos sólidos municipales en América y el Caribe. IDB/PAHO, 1998.

[14] Facing the Challenges of Natural Disasters in Latin America and the Caribbean: An IDB Action Plan. March 2000. IDB Special Report

[15] International Federation of the Red Cross and Red Crescent Societies. 2001. 2001 IFRC World Disaster Report. Chapter 8

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

changes and to undertake amelioration measures of its own. The region can help itself by reducing the rate of growth in the use of fossil fuels, deforestation, and the expansion of the agricultural frontier as well as by promoting alternative sources of energy to diminish environmental pressures. However, these efforts may come at a substantial economic cost without the judicious use of international cooperation mechanisms, such as the Clean Development Mechanism of the Kyoto Protocol.

MAIN CAUSES OF ENVIRONMENTAL DETERIORATION

It can be argued that most of the environmental problems described above are rooted in human activities and behavior that respond to distorted sets of incentives and signals. Historically, the region has depended on natural resource extraction as the basis of much of its economic development. In this context, however, natural resources and the environment have been considered open access resources with no economic value assigned to their scarcity or quality. Therefore, public and private investment, often led by short-term financial and rent-seeking considerations, have led a process of continuous environmental deterioration, with little or no provisions for managing and conserving natural capital. Hence, at the core of the environmental problems are essentially pervasive market failures that distort asset investment choice and resources allocation to the detriment of natural capital.

There are arrays of market failures in the context of property rights and externalities that affects the quality, availability and distribution of natural resources in all their dimensions (e.g., water, land, air, soil). Correcting these market imperfections requires decisive public intervention and effective policy tools, which are just beginning to appear in the countries of the region.

It can also be argued that coupled with market failures there is low capacity of governments to develop and sustain credible environmental institutions, and pass and enforce effective laws and regulations. Although there has been substantial progress in the past ten years, as mentioned before, there is still much more to be done. It needs to be recognized that the governments' past policy and institutional shortcomings may not necessarily be the product of lack of understanding or information. Rather, at the root of such government shortcomings is often the interplay of powerful political-economic interests that induce biased policies favoring the interest of those who have greater political and economic power to the detriment of the rest of society, and particularly the poor, whose fate largely depends on human and natural capital. This situation fuels poverty conditions and sets in motion a cycle of poverty and environmental degradation, which is evident throughout the region. Policy changes resulting in sustainable and equitable development may not take place unless such deep political imbalances are corrected within a framework of strengthened democratic process, effective civil society participation, and the modernization of the State. Therefore, market failures and government structures need to be corrected within a framework of transparent and participatory governance in which the right types of institutions and policy instruments are developed. This by itself will allow the region to establish the basis for economic growth that is environmentally sustainable.

It should also be recognized that achieving environmentally sustainable development

---

[14] El Desafío de los Desastres Naturales en América Latina y el Caribe. Plan de acción del BID. Marzo 2000. Informe Especial del BID.

[15] Federación Internacional de Sociedades de la Cruz Roja y de la Media Luna Roja. 2001. 2001 IFRC World Disaster Report. Capítulo 8.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

may require the progressive elimination of environmentally destructive subsidies and the use of resources to deal with market failures by increasing public investments in human and natural capital. In essence, there is a need to incorporate the environmental dimension in all spheres of public policy decision making, by establishing explicit linkages to environmental considerations in fiscal and sector specific priorities.

Finally, it needs to be emphasized that poverty reduction and social development are key determinants of environmental performance, and in the case of most countries in the region the poverty/environment links are evident, given the fact that the poor are the most affected by pollution, deficient basic services, lack of land security, and low levels of education, among others. Therefore, human capital and social development investments coupled with appropriate investments in natural capital should be part of the formula to increase productivity, income, and social well being. This will eventually increase the value that society places on environmental goods and services.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

LESSONS LEARNED



Several specific lessons can be drawn from the results of the Bank's programs and the overall performance of the countries in environmental and natural resources management. This section highlights some of the key lessons that cut across environmental issues, particularly those that have to do with institutional strengthening and the creation of managerial capacity; policy and incentive frameworks; the socio-cultural dimension; the role of the private sector; regional environmental management; and the Bank's internal procedures.

INSTITUTIONAL STRENGTHENING FOR ENVIRONMENTAL MANAGEMENT

The lessons learned regarding environmental management can be summarized in four broad areas in which greater effectiveness is needed: (i) environmental institutions, including the legal and regulatory frameworks; (ii) participatory processes and involvement of civil society; (iii) the choice and implementation of management instruments; and (iv) the regional dimension of environmental action, requiring trans-boundary institutional coordination. In essence, environmental management and natural resources management cannot be isolated from the national processes of modernization of the State that the Bank has identified as a priority area and which call for, among others, transparency, compliance with and respect for the rule of law, democratic representation, and suitable public and private roles in the delivery of services.

As for the *environmental institutions*, it is recognized that having a solid and credible normative and institutional framework at the central level is fundamental. Although that framework exists in practically all the countries of Latin America and the Caribbean, its capacities are still weak, particularly for key functions such as monitoring, oversight and compliance. It is also recognized that there is a need to foster inter-sectoral coordination (i.e. incorporating environmental capacities and linkages in productive sectors addressed by other ministries or agencies) and to increase awareness at the highest level of policy decision making. Greater support is also needed for local environmental management, as part of viable decentralization processes, so that the sub-national entities promote and implement actions in keeping with their local needs and aspirations. The weaknesses in environmental management and the capacities to manage natural resources locally constitute one of the main bottlenecks in many of the countries, which points to substantial needs for strengthening activities at this level. In any event, the lessons from Bank projects in institutional strengthening show that programs should support a longer term reform process, and Bank financing should strengthen the development of clear functions, as opposed to simply staffing and providing equipment. This should be done in line with the countries' capacities and attainable goals in the short to medium term, avoiding over-ambitious scenarios.

As for the importance of *participatory processes in environmental management*, special attention should be paid to integrating all relevant

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

stakeholders and civil society in activities for the design and implementation of plans and programs. Decision-making processes imposed from above still prevail in the region, offering little in the way of opportunities for participation. More active participation of civil society in the environmental management process generally increases the chances of success with environmental policies and the implementation of natural resources management programs, including those aimed at protected areas and biodiversity conservation or at promoting clean production technologies among medium and small size industries. Local environmental committees or councils in the region have shown how participatory processes can successfully incorporate the public sector, NGOs and civil society in environmental decision making.

Environmental education has been considered one of the key management instruments; accordingly, the Bank has incorporated this element in relevant support programs. While these efforts in education in many cases have contributed to raising public awareness, the lessons show that it is possible to be more cost effective when such activities are designed in connection with a specific purpose or goal than when done on a broad and generic basis, which may give rise to unfocused and relatively ineffective spending. The same problem arises with investments in other instruments such as *environmental information and monitoring systems*, when they are not designed around real demands and capacities for their use and assimilation.

As for the choice and implementation of *environmental management instruments to achieve targets and compliance*, the experience in the region shows how critical the selection and/or combination of instruments is for attaining effectiveness in environmental management. Equally or more important is the need to set targets that are economically, financially and politically realistic and viable. At present, the countries' major needs are in creating capacities for setting rational environmental targets and implementing effective management tools for achieving them. For example, many countries have declared areas for ecological protection, but lack the minimum instruments needed to achieve effective management. In addition, even if environmental ambient quality standards are defined at a realistic level, there is often a lack of instruments or political will for implementing them. In general, command-and-control instruments (e.g., penalties, licenses, auditing) have dominated the environmental agenda in the region, but with limited success. Economic and market-based instruments (fees, taxes, tax incentives, tradable permits, etc.) are gaining more acceptance and understanding in the region and should be considered necessary complements for attaining effectiveness and efficiency in management. The latter is also critical to address issues of financial sustainability, which is a major bottleneck in environmental institutional development.

From an institutional perspective, it is also worth noting that the trends towards economic integration among countries show that *regional environmental mechanisms and institutions* need to be developed and strengthened. Environmental issues are becoming central themes in initiatives for economic integration and regional trade agreements. The challenges for region-wide integrated environmental management need to be adequately addressed.

POLICY FRAMEWORK AND INCENTIVES

One key lesson is that environmental problems are not resolved solely by passing laws and creating institutions, or by investing in mitigation or remediation works. Rather, economic policies and incentives shape fun-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

damentally the behavior of individuals, firms and institutions. As discussed previously, at the heart of the environmental problem is the lack of effective incentives for environmental protection and natural resource management. Therefore, rational economic policies need to adequately internalize environmental issues which require a greater level of dialogue and objective understanding between decision makers in the economic and environmental arenas. These considerations are critical from the perspective of competitiveness and sustainable economic growth as well as the environment, since the systematic deterioration of natural capital eventually acts to slow productivity. Therefore, a more systematic approach is needed to fiscal, economic, and sectoral policies that adequately incorporate environmental benefits and costs and the real economic value of resources.

In relation to the above, the experience with investments in natural resource management shows that these investments often fail to attain sustainable goals, since the countries do not advance sufficiently in correcting key policy problems in areas such as land markets, credit markets, and agricultural subsidies, among others. To the extent that the prices of key resources, such as water and energy, do not reflect their real value, sector reforms can entail an environmentally inadequate and unsustainable use of these resources. The foregoing confirms the need to gradually advance and create technical and institutional capabilities in the countries for the design of viable environmental policy instruments, including diverse types of economic instruments adapted to institutional capacities in the regions. The experience of recent years in environmental management also points to the major need for countries' fiscal policies to explicitly undertake the financing of environmental public goods, seeking innovative forms of financing consistent with fiscal discipline and macroeconomic stability. In some cases, it may be a matter of increasing efficiency in public spending and inter-sectoral synergies. It is not uncommon to see duplication of project financing and tasks among ministries and government agencies.

SOCIAL AND CULTURAL DIMENSIONS

Environmental quality and the sustainable management of natural resources go hand-in-hand with social development, and therefore this relationship is at the core of the concept of sustainable development. A large part of natural resource management programs have a strong social focus, either seeking better health indicators or fostering income generation and improved living conditions among small producers. Experience has shown that the possibilities of success of conservation measures are limited (including biodiversity conservation) if they are not linked to attention for the needs of the social and human environment. For example, indigenous peoples have demonstrated how their culture, traditional knowledge, and ancestral rights are linked to the sustainability of the natural resources on which they depend. In addition, the empowerment of small rural communities and small farmers increases the potential for sustainability when they participate actively in the processes and perceive the benefits of conservation and development. Finally, the role of women in both rural and urban development programs has proved essential for guaranteeing community involvement and long-term commitment to the environment.

The social and cultural dimension has proved to be essential when directing resources to specific areas or watersheds, both in rural and peri-urban settings. By promoting integrated, socially-inclusive local watershed management projects, communities throughout the region have been able to improve their environmental sustainability, while increasing community participation and awareness. Through these programs, issues related to gender and the role of

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

women in natural resource management and conservation have been recognized as essential for long-term sustainability. The importance of social inclusion has been equally tested in urban neighborhoods, where local participation, community awareness, participation by women and integration of cultural values have been key to success of urban renewal and environmental quality enhancement programs.

PRIVATE SECTOR PARTICIPATION AND NONGOVERNMENTAL ORGANIZATIONS (NGOS)

Private investment, including NGOs, plays an increasingly important role in the countries' economies. Thus it is essential that the private sector internalize the environmental costs of its actions as part of an efficient decision-making process. Furthermore, the lessons of experience also show that the environment can be good business, and that the driving force of private initiative and investment can contribute to valuing and protecting the environment. The role of the private sector and NGOs has proved to be fundamental and effective in areas such as: (i) environmental markets associated with agricultural production; (ii) markets for environmental services associated with forestry, biodiversity, renewable energy, (iii) ecotourism, as an important and promising activity that directly enhances the value of natural resources and environmental attributes; (iv) concessions for the private management of environmental components (protected areas, wastewater treatment); and (v) investments in industrial decontamination, integrated waste management, and clean production processes. As part of the processes of environmental management, it is important to strengthen these positive aspects of private initiative, business development and NGO activities, including actions that generate capacities in associations, chambers of commerce, and other stakeholder groups that could make environmental management more effective. A critical aspect for private sector involvement in environmentally sustainable projects is the promotion of clear rules, transparency, oversight and accountability. Any improvement of private sector performance will depend on how successfully these factors are addressed.

EFFECTIVENESS OF THE BANK'S INTERNAL PROCEDURES

Preparation and design. The environmental review process has evolved in the Bank. Since the late 1980s, the Bank has adopted an environmentally responsible and cautious view in selecting and designing its operations. The environmental impact assessments (EIAs) required for complex and environmentally-relevant projects include the evaluation of alternative designs, the identification of negative impacts, and the determination of adequate measures to protect the environment prior to the review and possible approval of the operation by the Bank. Additional work needs to be done to incorporate environmental concerns at the policy or program level, using methodologies such as Strategic Environmental Assessment (SEA). This effort is important to address up front social and environmental issues related to broad regional development programs and policy loans. The proper application of SEAs coupled with good project level environmental impact assessments are necessary in the development and review of large infrastructure projects, given the complexity of operations, their indirect impacts, the need to establish a constructive dialogue with the affected stakeholders, their bi-national or regional dimensions, and the often-fragmented institutional framework and scant resources available in many cases. Special attention should be given to collaborative mechanisms within the Bank to provide back-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ing to the teams that design and monitor such projects. The active collaboration among ank departments, country offices and the central divisions can help address the direct and indirect impacts of complex operations, both public and private, and enhance the overall environmental, social and economic sustainability of the areas influenced by projects. Several lessons have emerged from this process that show:

- The importance of integrating the social dimension in evaluating project impacts, which is reflected in the composition of the Committee on Environment and Social Impacts (CESI). Integrating the social and environmental dimension in operations also makes it possible to provide significant added value to Bank operations from their conception.
- The need to hold the project teams accountable for their environmental and social obligations, accompanied by a rigorous framework for environmental and social review that guarantees operations will be of high quality.
- The importance of having competent and trained environmental professionals on the project teams and in the operations divisions, exploiting environmental opportunities and minimizing the social and environmental problems in the programming, design and implementation of operations.
- The need to facilitate the work of project teams with up to date technical guidelines, procedures and instruments for good practices.
- The importance of establishing a constructive dialogue with the communities that benefit from or are affected by an operation, and with civil society in general. Such a dialogue makes it possible to inform and consult with the population, analyze the importance of the impacts in light of local values, establish priorities that reflect specific needs, and integrate cultural and gender dimensions in the design of the operation.

Implementation and monitoring. The quality of the implementation of operations by the executing agencies in the borrower countries continues to be an area in need of attention. Several Bank studies confirm that there is variable quality in implementing the environmental dimension of projects, a dimension which needs to be properly evaluated. During project execution there are risks that the contractual environmental obligations will not be met, either for internal reasons—lack of training or resources—or for external reasons, such as a difficult socio-political context. The Bank's capacity to identify and respond to an environmental problem in an operation under way also depends on strengthened local capacities, including the role of the Bank's Country Offices. Therefore, mechanisms for ensuring environmental quality and effective performance during project execution need to be strengthened. Some experiences have shown that operational environmental supervision coupled with local oversight and civil society participation can facilitate and make more effective the work of the Bank's country offices. This aspect can be anticipated as part of loan financing.

Private Sector Investments. By their nature, private sector projects pose challenges that differ from their public sector equivalents.For example, the problem referred to above, associated with transferring responsibilities from the design to the implementation phase of operations, does not occur in the private-sector projects of the Bank. Private sector operations are designed, implemented and monitored by the same PRI team based at headquarters. Other challenges, however, may be caused by the lack of a clear division of responsibilities between the private sector and governments, or in difficulties in handling such issues as pre-existing liabilities, or in mitigating indirect impacts of an invest-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ment which may entail shared responsibilities. The frequent lack of clear environmental regulations, or their consistent application may also cause difficulties for the private sector. In this regard, in addition to current PRI efforts to ensure the incorporation of appropriate environmental health and safety clauses into project legal documents, a coordinated effort should be carried out with regional departments to support countries in developing and strengthening their own capacities, so that the issues at hand could be addressed with any type of financing.

OVERVIEW OF THE SCOPE OF THE BANK'S RESPONSE AND ROLE IN THE LAST DECADE

Environmental issues at the Bank were explicitly recognized over twenty years ago. In 1979, the Bank adopted its Environment Policy mandating the need to protect environmental quality in Bank operations. Since 1990 the Bank has adopted formal procedures on environmental issues to respond to the countries' demands and to strengthen the performance of the Bank's operations. Then, fostered by the Eighth Replenishment (1994), the Bank's environmental portfolio climbed in the 1990s to US$964 million per year, accounting for about 15 percent of all Bank operations during the decade. The Bank's new project pipeline reflects the wider diversity and scope of environmental issues addressed, as it has come to include projects for natural resource management and environmental quality in a more coherent and integrated fashion.

The Bank's environmental activities have concentrated on three fronts: (i) environmental quality control of its entire operations through internal review procedures; (ii) financing environmentally targeted operations; and (iii) developing nonfinancial products to support the countries' capacities to address environmental problems, through technical cooperation and studies, capacity building, and policy dialogues, among others. A detailed report on lending and nonlending operations to support the environmental needs of the region can be found in the Bank document "*Facing the Challenges of Development: The IDB and the Environment, 1992–2002.*"

Environmental quality control in Bank operations. The Bank has developed an internal process of environmental evaluation, which is applied to all Bank programs and operations. This process ensures that consideration is given to issues of social and environmental feasibility during the design and implementation of environmental and nonenvironmental operations. Through its environmental supervision procedures, the Bank has sought to internalize environmental management in its operations, and to ensure the environmental feasibility of each operation. In addition, the Bank ensures that its own policies on resettlement, rights of indigenous groups, women in development, and public health are complied with.

Environmentally targeted operations. The Bank's environmental operations have been channeled to various priority areas in response to requests from the borrower countries. Although a large part of the lending resources in the environmental area have been channeled to potable water and sanitation projects (approximately 57 percent in the last 10 years), the project portfolio has been diversified in recent years to incorporate areas that bring together broader aspects of development, such as watershed management, sustainable regional development, sustainable energy, protected areas and biodiversity, and natural resource management. Throughout the past decade, loans in the areas of institutional strengthening, environmental management, pollution control, rural development have also held an important place in the project portfolio, while new areas

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

such as ecotourism, coastal resource management, and disaster prevention and mitigation are receiving increasing attention.

Technical cooperation and non financial products. In addition to its loan portfolio, the Bank has supported environmental and natural resources management through numerous technical cooperation (TCs), financed by nonreimbursable funds through its Fund for Special Operations (FSO) or Donor's Trust Funds. The volume of resources in TCs directed to the environment and natural resources initiatives over the last 10 years (1992–2001) reached nearly US$200 million. In 2000 alone, the Bank financed 67 technical operations in the environmental area for an amount of approximately US$30 million, which accounted for 45 percent of all TCs financed by the Bank that year.

Private sector financing in environmental areas. As part of its strategy for the private sector on environmental matters (2000), the Bank, through the MIF, has financed programs to support environmental management systems (e.g., ISO 14001 certification), as well as the creation of investment funds for the adoption of clean technology, environmental services, and sustainable uses of renewable energy sources. These programs are aimed mainly at small and medium enterprises, which generate the largest number of jobs in the industrial and commercial sectors in the region. In addition to the MIF, the Bank's Private Sector Department (PRI) has developed environmental, social, health and safety management and supervision mechanisms in its operations, adding environmental staff to the PRI, preparing guidelines for borrowers and staff, offering training, ensuring mitigation of impacts and risks and promoting environmental enhancement measures in private sector investments. The PRI has also directly financed private sector projects related to water supply and wastewater treatment, renewable energy, and efficient energy generation, transmission and distribution.

Advances on social and indigenous issues. The Bank has made significant advances in addressing indigenous issues recognizing the needs of indigenous groups for preserving their socio-cultural values and ancestral rights to their land and their natural resources. An increasing number of operations are centered on these groups' needs, and specific methodologies have been created to incorporate socio-cultural dimensions and the traditional knowledge of indigenous communities throughout the different stages of project preparation, design and implementation. Specific communities and regions that have benefited from this intervention include the Darien in Panama, the Garifuna and Miskito communities in Honduras, and the Andean communities in Ecuador.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



AREAS FOR BANK ACTION

This section sets forth guiding principles and general priority areas of action that the Bank would promote or support through financial and non-financial instruments in the context of the pipeline of operations agreed with each borrowing country. In particular, this section sets the overall framework in which the Bank would foster the environmental agenda on a cross cutting basis, without being prescriptive, the framework would provide an orientation for carrying out actions flexibly on a country by country basis. In the fifth section of this Strategy document, specific priority actions for Bank internal work and procedures are presented.

This Strategy identifies, from an environmental perspective, two key and fundamental areas that on a cross-cutting basis will contribute to addressing the main causes of environmental problems in the region. These two inter-related areas are environmental governance, and enhanced policy integration for the development of an appropriate incentive framework for environmental management.

Environmental governance is a fundamental element for attaining adequate conditions for environmental management. In its broad definition, "environmental governance" is the process that links and harmonizes policies, institutions, procedures, tools, and information to make it possible for a wide array of stakeholders (public and private sector, NGOs, local communities) to make fundamental decisions, manage conflicts, seek points of consensus, and be accountable for their actions. It is based on clear public and private responsibilities, respect for and compliance with the laws, and local empowerment.

Enhanced policy integration and the development of an appropriate incentive framework for environmental management places environmental actions in a truly cross cutting dimension in all spheres of policy decision making, particularly those which are critical to advance the agenda for the priority areas of the Bank's Institutional Strategy (i.e., modernization of the State, competitiveness, social development, and economic integration).

In addition to these principles, the important underlying processes that the Bank will adhere to, are: (i) *achieving program and project quality*, reaffirming the Bank's commitment to the effectiveness and overall quality of its project portfolio; (ii) *transparency, information and disclosure*, reflecting a principle that recognizes the importance of all actors being informed and/or having easy access to information on processes that they impact or are impacted by, directly or indirectly, (iii) *inter-institutional/inter-agency coordination*, acknowledging that the Bank is one of the many actors supporting the countries' initiatives, which makes it necessary to pool efforts and create synergies to obtain effective development objectives; and (iv) *adapting to the particular realities of each country*, recognizing that each country is unique and that environmental management models adopted should be in line with development strategies reflecting local, national, and regional realities, with priority given to the integration with national initiatives for poverty reduction.

Copyright © by the Inter-American Development Bank. All rights reserved
For more information visit our website: www.iadb.org/pub

In setting environmental priorities for Bank support in a particular country, specific considerations will be given to the Bank's Institutional Strategy, the Millennium Development Goals (MDGs), and the Bank's Country Strategies.

The Bank's Institutional Strategy. The nature and scope of the Bank's support to borrowing countries in the environment area also should be oriented by the priority areas defined by the Bank's Institutional Strategy, particularly the need to reduce poverty and promote sustainable economic growth. The environmental dimension is included horizontally in the implementation of the Institutional Strategy by establishing specific links to the four priority areas. Therefore, the framework for prioritization set forth in the Environment Strategy is essentially institution-wide, and can be applied to any specific sector. Annex 1 summarizes how the Environment Strategy, through these links, relates to the overarching objectives of poverty reduction and sustainable economic growth.

The Millennium Development Goals (MDGs). The MDGs were adopted by the 189 members of the United Nations General Assembly in the 2000 Millennium Declaration. The declaration sets forth the main challenges humankind faces, defining responses and specific measures for gauging results in light of development commitments. The MDGs are grouped into eight categories, each with their own objectives, goals, and indicators. Three of these categories relate directly to environmental considerations. In the context of specific Country Strategies, the Bank will assess and consider ways to support countries in fulfilling their commitments regarding the MDGs. In this regard, references will be made as to how each country is advancing to meeting the MDGs in three categories involving environmental indicators: (i) *reversing the loss, waste, and degradation of natural resources*, for which goals and indicators must be specified for forest cover, biodiversity protection, energy efficiency, and CO2 emission reductions; (ii) *improving access to sources of safe and clean water*, with specific targets to halve by 2015 the proportion of people without sustainable access to safe drinking water; and (iii) *improving living conditions in marginal areas*, with targets and indicators to improve the lives of slum dwellers, improve sanitation and increase access to secure tenure.

The Bank's Country Strategies. The key programming instrument with which the Bank establishes a dialogue and formally agrees with each country on a specific project pipeline is the Bank's Country Strategy, guidelines for which were recently approved by the Board of Executive Directors (GN–2020-6). It is in this phase that the cross-cutting dimension of the environment should be appropriately incorporated, seeking strategic coherence among sectors, and targeting to define the right priorities. Such prioritization should be done in the context of specific studies and assessments at the local, national, and regional levels, to strategically set the framework of the Bank's environmental support in each country. The Country Strategies need to take into account both the Bank's Institutional Strategy and the MDGs, as well as the importance of supporting countries to comply with international environmental agreements to which they have signed.

Taking into account the stage of institutional development and challenges in the region, as well as the Bank's comparative advantage, it is recommended that the Bank focus its attention on addressing environmental governance and the development of policy frameworks that create the right set of incentives for environmental management, making specific links to the four priority areas of the Bank's Institutional Strategy.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ENVIRONMENT AND MODERNIZATION OF THE STATE

Environmental Governance, as presented in this Strategy, is fully consistent with the principles of the *Strategy for Modernization of the State*. The actions proposed in the Strategy for Modernization of the State include: establishing adequate institutional capacities, legal and regulatory frameworks, and justice systems; promoting representative democracies; decentralizing political power, democratizing the sub-national governments, and strengthening local management capacities; creating adequate organs for oversight, inspection, and supervision to ensure transparency in public administration; fostering the participation of civil society in designing and implementing public policies; and taking advantage of information systems that promote connectivity among stakeholders, as well as transparency. These actions are consistent with the needs and limitations addressed in the overall diagnosis and lessons learned for the Environment Strategy.

In terms of environmental governance, Bank programs will seek to develop and consolidate a framework for environmental management that is transparent, participatory and one that will lead to set the right priorities for the sustainable management of natural capital and the quality of the environment. In this regard, it is recommended to focus on three areas: (a) strengthening institutions and civil society participation; (b) strengthening regulatory frameworks; and (c) developing effective sets of environmental management instruments.

Strengthening institutions and civil society participation. Special attention should be given to the following: (i) strengthening the countries' capabilities to undertake key institutional functions and seek ways to guarantee technical and financial sustainability of environmental institutions, including opening up opportunities for generating adequate financial resources for environmental management; (ii) strengthening processes for local environmental management at different levels (municipal, watershed; indigenous communities); and (iii) developing mechanisms for empowering civil society participation in decision making processes, including the use of environmental education tools to change individual and community behavior in favor of the environment.

Strengthening regulatory frameworks. A key area of Bank support should be to strengthen central and local governments to exercise credible and transparent regulatory and standard-setting functions, with an emphasis on monitoring, oversight, enforcement, and conflict resolution. Special attention will be given to local organizations that have a direct and preponderant role in natural resources management, recognizing that sub-national entities and local governments, both urban and rural, perceive the problems first-hand and can act on them directly. In addition, monitoring and follow-up mechanisms should be strengthened, including the role of the universities and academic centers, chambers of commerce, centers of clean production, NGOs, and others in areas where they have comparative advantages for promoting sound environmental management.

Developing effective sets of environmental management instrument. The diagnosis shows that the biggest management challenge in many counties is the lack of proper management instruments to effectively achieve targets and goals. Special attention will be given to the need to mainstream environmental education and awareness in social development programs. Other important instruments that need to be strengthened and/or developed include environmental and natural resource information systems; land use planning with special focus on preventing physical vulnerability; and an array of command and control and incentive based economic instruments. It

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

is essential that the countries develop capacities to adopt different types of instruments, based on specific goals and objectives, which the Bank can support selectively, in association with clear indicators of results.

ENVIRONMENT AND COMPETITIVENESS

The Bank's *Competitiveness Strategy* indicates that improving competitiveness and productivity should be the main drivers of economic growth, which is only sustainable if it leads to preserving and improving the natural resource base. The quality and quantity of the natural resource base are key elements of the conditions needed for sustainable economic growth and competitiveness, as it constitutes a form of capital (natural capital) that complements human capital as well as financial and physical capital. This section delineates three areas which, from the environmental perspective, are fundamental for fostering competitiveness: (a) *enhancing the productive value of natural resources and their environmental function and services*; (b) *facilitating investments and market development and promoting private sector participation in environmental related activities*; and (c) *tapping global and regional environmental markets.*

Enhancing the productive value of natural resources and their environmental function and services. The long-term competitiveness of the countries will be strengthened by actions that preserve the productive capacities of natural resources and guarantee their sustainability. In this context, priority actions that are consistent with competitiveness, from an environmental perspective, include: (i) income-generation and the development of rural economies based on the sustainable and efficient management of their natural resources and watersheds, including forestry and the management of protected areas; (ii) developing ecologically-sustainable tourism, capitalizing on the environmental attributes that make it more attractive and economically valuable; (iii) rational management of surface and groundwater resources; (iv) rational management of coastal marine resources; (v) financially sustainable management of protected areas, biodiversity protection and biogenetic research and development, guaranteeing benefits and patent rights to local indigenous communities; and (vi) environmentally sound land-use management, taking into account the management and preservation of green areas, cultural and historical heritage and reducing physical vulnerability.

Facilitating investments and market development. At present, several productive sectors (public as well as private), and especially those in the export sector, may be at a relative disadvantage in world markets, as they do not have access to support mechanisms, information, or clear standards and procedures for environmental issues, limiting their access to foreign markets for various products. The Bank, also in line with activities linked to environmental governance, can contribute to the development of environmental instruments and processes that will facilitate business development, private investments related to environmental goods and services, ecotourism, certification and licensing mechanisms, and dissemination of relevant market information.

The participation of the private sector in environmental management activities has a potential that must be utilized. Various forms of management, including concessions, service contracts, or joint ventures in the context of private public partnerships may be applicable to various aspects of environmental management. These include the delivery of public services like potable water and sanitation and solid waste management, administration of protected areas, sustainable ecotourism, and the management of forests. Furthermore, from an environmental per-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

spective, small and medium sized enterprises have a major opportunity to improve their competitiveness and at the same time contribute to improving environmental and health conditions by adopting those cleaner production processes which can also cut production costs due to more efficient use of energy, water, and other inputs. This is an area of action that is complementary with initiatives such as: (i) establishing systems of certification, accreditation, and regional environmental supervision and incentives; (ii) supporting the dissemination and implementation of the ISO 14000 standards; and (iii) supporting the business sector to take on the challenges posed in the environmental agenda of the World Trade Organization. The lines of action of the MIF point in this direction, and the Bank can capitalize on lessons learned and successful cases, to support greater and more effective participation of the private sector.

Global and regional environmental markets. The global and regional dimension of environmental policy is receiving greater attention, and the countries of the region need to be prepared to take on the new challenges and opportunities this represents and to capitalize on global and regional opportunities. For example, the Clean Development Mechanism (CDM) is a flexible mechanism for meeting developed countries' greenhouse gas emission reduction targets established under the Kyoto Protocol. The CDM will make it possible to implement carbon-mitigation activities and to promote increased use of alternative energy sources. The region has some comparative advantages for participating in these regional and global processes, and the Bank can offer support for designing and developing specific policy instruments and supporting capacity building. As described in the Environment and Regional Integration priority area below, the strategy ties the application of these mechanisms to specific actions in a regional context (such as managing watersheds, reducing vulnerability in border areas, management of rivers and aquifers, protecting biodiversity in regional biological corridors, managing forest resources, and developing cleaner energy resources).

ENVIRONMENT AND SOCIAL DEVELOPMENT

Environmental degradation takes its toll mainly among the poor (urban and rural), and therefore addressing the links between environmental management and social development is of utmost importance. Through these links, environment and natural resources management should contribute to reducing poverty conditions and increasing overall quality of life, recognizing that investments in environmental improvements as well as natural resources are sources of job creation, sustainable income, and improved living conditions. From an environmental perspective, four specific areas that require priority targeting in a social development context are: (a) health and environment; (b) rural development; (c) indigenous groups, traditional communities and gender; and (d) physical vulnerability to natural disasters and environmental risks

Health and environment. Water and air pollution, unsafe disposal of solid waste, soil and food contamination are major sources of diseases, increased mortality rates and degraded living conditions for millions of urban and rural dwellers. In this context, special priority should be given to addressing these problems by reducing their environmental causes. Consistent with this priority are programs that seek to create conditions for clean, safe and healthy urban and rural environments through actions that improve access and coverage of basic services, particularly water and sanitation services, as well as programs that reduce overall air, water, and soil

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

pollution. Of growing importance for the Bank is the need to address in a more integrated manner urban development issues under the concept of livable cities, which includes sustainable urban transport, ecologically-viable land uses, open space programs, historic preservation, and urban up-grading of city centers, among others.

Rural development and natural resources. Sustainable rural development and natural resources management are part of the same coin. It is also in the context of rural settings that greater needs for social development arise. Therefore, Bank programs should respond to challenges and opportunities for sustainable rural development in such a way that standards of living and quality of life of rural communities are improved. Proper attention should be given to legal and institutional reforms, the implementation of integrated watershed management practices, the introduction of conservation practices, the design of instrument to compensate farmers for environmental services, and the need to strengthen the management of protected areas.

Indigenous communities and their natural resources. The Bank will continue to make progress in addressing the particular needs and problems of indigenous communities. The objectives for conservation and integrated development of territories should be based on two fundamental aspects: (i) traditional knowledge; and (ii) cultural uses of the territory, which is the way indigenous communities manage and regulate their natural resources. Bank projects will also promote social inclusion and intercultural dialogue by applying socio cultural guidelines and "ethno engineering" methodologies currently being developed at the Bank.

Vulnerability to disasters and environmental risks. The Bank will continue to play a proactive role in emphasizing reducing vulnerability, mitigating and reducing the impact of disasters, and creating hazard insurance schemes, with particular attention to the needs of the poor and marginalized communities. As described in the diagnosis, vulnerability to natural phenomena is fueled by environmental degradation, particularly through inadequate land use management. A special priority is the updating of the Bank's Natural Disaster Action Plan. The Plan places the Bank at the service of the countries in designing and implementing Integrated Prevention and Mitigation Systems, and in comprehensive risk management.

ENVIRONMENT AND REGIONAL INTEGRATION

The Bank has defined regional integration as one of its priority areas of action, acknowledging the strategic need for the region to be well-positioned in the global economy and the opportunities offered by trade and the opening of markets. The Regional Integration strategy identifies four major areas of action, which are: regional infrastructure; consolidating market access; institutional strengthening; and functional cooperation in the creation of regional public goods. The environmental dimension should be inserted in each of these areas of action. The environmental context should not be limited only to mitigating environmental impacts but should also encompass protecting the existing resource base and generating new opportunities based on the environmental attributes and natural resources. Priority areas for Bank support include: (a) regional environmental institutions; (b) management of regional public goods; and (c) environmental quality of regional infrastructure initiatives.

Supporting regional environmental management, institutions, and processes. The objectives of increasing trade and integrating physical infrastructure require immediate and

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

decisive actions for the countries to have a harmonized framework of environmental rules and procedures. These are basic elements that should be seen as facilitators of integration and not as obstacles, since in the medium and long term the absence of such elements could become a formidable obstacle to integration. Therefore, the Bank can play an active role, seeking early-on in the process to ensure that the harmonization of instruments and procedures for environmental management is a central part of the integration processes being promoted, along with the development of regional environmental information sharing mechanisms. This will require a regional institutional development effort, which to date has been limited. In addition, the Bank may provide the necessary technical assistance to the countries, as required, so that the environmental and natural resources implications of international trade agreements are fully understood.

As part of regional institutional development, specific areas that deserve special interest include the needs for small island states of the Caribbean, which require support for addressing unique environmental conditions; and needs that arise in the context of the collective rights of indigenous groups in biological corridors that do not recognize political boundaries, or where protected areas intersect with indigenous territories.

Management and use of regional public goods. Many countries are naturally interrelated by their transboundary river basins, other shared natural resources, the location of ethnic groups, biological corridors, and economically interdependent cross-border areas. In this context, a series of regional public goods and externalities are generated that merit the attention of two or more countries. The Bank, in the context of implementing the integration strategy, will identify priority niches and actions in relation to regional public goods. These will be supported as requested by the regions or countries, giving special priority to the following: (i) preventing and reducing physical and social vulnerability, as a result of possible natural phenomena; (ii) protecting and respecting cultural and ethnic values not governed by political boundaries, and which depend essentially on the group's relationship with its natural environment; (iii) protecting biodiversity and endangered species, as well as fragile natural areas and ecosystems that provide regional environmental services; (iv) promoting the sustainable development of cross-border areas, incorporating the integrated approach to watersheds and participation in decision-making; (v) addressing multinational issues related to coastal and marine resources; and (vi) promoting innovative opportunities for capitalizing on markets for environmental services.

Environmental quality for regional infrastructure. Regional integration opens up opportunities to foster initiatives for physical integration of roadways, power and water supply, flood protection, and other areas that require major investments in infrastructure. The Bank will selectively support these processes, ensuring that they are accompanied and preceded by environmental and natural resources management components, such as: (i) transparent processes of consultation involving broad sectors of society, as well as population groups affected directly or indirectly by projects; (ii) environmental impact studies that show both the direct and indirect impacts, benefits and costs, as well as analysis of the economic and social impact of alternatives; (iii) actions for institutional strengthening in each country, as needed; and (iv) environmental evaluation, forecasting and monitoring systems.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

OPTIONS FOR BANK SERVICES AND IMPLEMENTATION GUIDELINES



While the previous section describes principles and priority areas that will be promoted in the context of loan operations, both public and private, as well as technical assistance to countries, this section identifies specific actions related to the Bank's internal work and processes. A set of recommended priority actions for improving overall environmental performance is presented, with lines of action linked directly to the Bank's project cycle: programming, design, and implementation. Included in this is a specific line of action to enhance the environmental role of the private sector of the Bank.

The purpose of these proposed actions is to strengthen the processes of environmental mainstreaming, such that the cross-cutting and horizontal nature of environmental issues is fully established, as well as to strengthen and improve activities that ensure that all Bank financed investments, public and private, are consistent with sound environmental practices. The priority actions proposed in this section are incorporated in the *Integrated Plan for the Implementation of the Strategies* which inter-relates the execution of all of the strategies under the framework of the Bank´ s Institutional Strategy.

ACTIONS TO STRENGTHEN THE BANK'S PROGRAMMING PHASE

The programming phase defines the strategic framework for Bank's activities in each country. Therefore, it is at this stage that the Bank's priorities should be established and that the horizontal dimension of environmental considerations should be appropriately incorporated, seeking strategic coherence among different sectors and programs. The key-programming instrument is the Bank's Country Strategy, whose guidelines were recently approved by the Board of Executive Directors (GN–2020-6). Following these guidelines, it is important to accurately identify the demand for environmental actions across sectors in this phase, properly weighing the objectives of environmental protection and economic growth. It is at this stage that the Bank also can properly and in timely fashion screen projects to promote environmentally sound pipeline of projects.

To this end, the Environment Strategy proposes priority actions that will strengthen the Bank's capacity to strategically incorporate the environmental dimension at the pre-programming and programming phase. These actions are meant to feed into and enhance preprogramming processes and provide improved information and coordination mechanisms for better decision making. The proposed actions are: (i) environmental priority setting through country environmental analysis, sector reviews, diagnosis and stakeholders' dialogue; (ii) approval of a new Bank environmental policy; (iii) support to effective implementation of sector strategies; and (iv) strengthening regional environmental dialogue and regional programming exercises.

Environmental priority setting in pre-programming and programming exercises. The objectives of these activities are to undertake relevant sector reviews and diagnosis related to

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

environment and natural resources in a particular country; to promote participatory processes and broad stakeholder feedback in priority setting; and to facilitate cross-sectoral policy dialogue, particularly between environmental institutions and economic and finance ministries. Out of this process, a more focused and strategic role for Bank action, in terms of supporting both public and private investment, should result. The process also should define the direction and desirable targets to be achieved, taking into account this Strategy's basic principles (i.e., environmental governance and policy development); its relationship with the Bank's Institutional Strategy; and the Millennium Development Goals in a country-specific context. In some countries, such as Ecuador and Guyana, the Bank has already supported country-level environmental strategies consistent with the proposed approach. The key is to establish the appropriate incentives to make this process relevant to final decision making in country programming negotiations and approval.

Approval of a new Bank environmental policy. A Bank policy establishes specific mandates for Bank action. Therefore, given that the current Bank's environment policy dates from 1979, a new policy will facilitate the process of Bank/country dialogue and will provide enhanced transparency and accountability in the cycle of identification, design, and implementation of Bank projects. Because of the importance of this policy, its approval should be accomplished during the first year of the Strategy implementation.

Support to the effective implementation of Bank sector strategies. Several sector level strategies have been independently developed over the years, mainly in the areas of energy, water resources, coastal/marine resources, and rural poverty reduction. A coordinated implementation of their recommendations and action plans will be promoted, including the development of a framework for new sector strategies. This will help to orient project teams and executing agencies to adopt best practices on a sector by sector basis. These strategies should also help set the basis for key policy dialogues and policy reforms. Special attention and support will be given to the development of the Strategy for Rural Economic Development and its links with sustainable natural resources management.

Strengthening regional environmental dialogue. Given the increasing importance of regional economic integration, and the fact that the Bank has had limited exposure to regional initiatives from an environmental perspective, it is important to promote a more systematic dialogue to strengthen the Bank's regional programming exercise, including its links to country-level programming. These dialogues will contribute to developing regional understanding and knowledge on issues such as: strategic environmental management for transnational investment projects; harmonizing norms, policies, and standards; managing regional public goods; trade and environment; biological corridors; and global challenges. An important instrument that will be strengthened within the Bank, in its capacity as implementing agency, is the Global Environment Facility (GEF).

ACTIONS TO STRENGTHEN PROGRAM DESIGN

Traditionally, the most important part of the Bank's efforts has been directed towards program and project design. This is also reflected in the environmental arena, in which the Bank has a well developed mechanism for addressing quality control issues at the design level. Significant level of mainstreaming also has been achieved, as all of the departments, including the private sector, have environmental staff and procedures in place. Nevertheless, there is room for improvement, and

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

this strategy has identified priority activities in three areas: (i) *strengthening environmental quality of Bank operations*; (ii) *strengthening environmental dialogue and expertise on key policy and technical issues*; and (iii) *development of studies and methodologies for formulating baseline data and indicators for product, result, and impact indicators.*

Strengthening environmental quality of Bank operations. To strengthen environmental quality, this Strategy proposes the development of specific operational guidelines, good practice studies, in-house training, help desks and information services. The main objective is to facilitate and provide project teams, both for public and private operations, with tools to develop environmentally sound projects and programs. This process will start by addressing at least one sector during the first year in an integrated manner followed by other sectors in the next two years. Special priority will be given to promoting inter-sectoral linkages to effectively internalize environmental considerations in issues such as the national/regional impacts that generally stem from sector policy reforms; large physical infrastructure projects, including those based on the extraction of natural resources; and infrastructure projects that are part of regional integration initiatives. In this context, the Bank will seek to assure the appropriate application of both upstream environmental assessment (strategic environmental assessment) as well as downstream environmental impact assessment at the specific project level. Special attention will be given to needs and issues related to private sector financing, including the microenterprise, and the importance that loans include specific financing mechanisms for oversight and monitoring.

Strengthening environmental dialogue and expertise on key policy and technical issues. The purpose of these activities is to keep the Bank abreast of know-how on critical issues and to contribute with state-of-the-art studies to advancing the discussion of relevant policy issues. Of specific relevance are those activities that seek to improve governance and the development of key environmental management instruments, particularly the application of effective compliance mechanisms and economic instruments to enrich program design. During the implementation of the strategy special priority will be given to the following areas: institutional environmental management, water resources; rural development; watershed management; coastal and marine resources, biodiversity; forestry; sustainable energy; climate change; urban environment; regional public goods; and disaster prevention.

Development of studies and methodologies for formulating baseline data and measuring product, result, and impact indicators. In project design, the procedures and methodologies that should be used in obtaining baseline data and measuring the various types of project level indicators will be spelled out and included in the project financing. It is important that the Bank's central and operational departments develop appropriate capacities in this regard. This will require implementing the following activities: (i) developing guidelines and methodologies for designing environmental and natural resources related baselines; formulating indicators; and quantifying impacts to be incorporated into the design and implementation of Bank programs, (ii) strengthening the institution's professional capacity, and (iii) designing and maintaining an adequate information system on the environmental performance of the operations.

ACTIONS TO STRENGTHEN PROGRAM IMPLEMENTATION PHASE

Within the Bank's project cycle, the implementation phase is perhaps the most important one, given that at this stage Bank financing has direct results and impacts in all

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

dimensions (i.e., institutional, social, economic and environmental). The country offices and their environmental specialists have an enormous responsibility in project oversight. In this context, the Environment Strategy proposes to implement actions to strengthen: (i) the capacities for monitoring and evaluation in the Bank's country offices; and (ii) the processes of local oversight.

Strengthening environmental monitoring and evaluation capacities at the country offices. The Strategy recognizes that at present, serious time and resource limitations affect the work of the environmental specialists in the country offices, which limits the possibility of improving project performance while in execution. In addition to verifying specific environmental mitigation loan clauses, it is necessary to strengthen monitoring capacities for follow up and overall environmental assessment. The strategy recommends to carryout, as a first step, a capacity- and needs-assessment for environmental supervision at the country office level, taking into account the scope of their project portfolio. During the following two years, specific strengthening activities for capacity building will be implemented, on a case by case basis, taking into account cost implications and sources of funding.

Operational environmental supervision and local and civil society oversight. Complementing the above, it is also recommended to enhance capacities for environmental supervision based on local and civil society oversight. This mechanism should be designed to improve overall project performance while in execution. As a first step, a methodological approach for strengthening such a system should be prepared jointly by SDS, the Legal Department and the Regional Departments, including the Country Offices, for approval by the CESI, with the view of providing guidelines and best practices for project execution.

ACTIONS TO ENHANCE THE ENVIRONMENTAL ROLE OF THE PRIVATE SECTOR OF THE BANK

In the fourth section of this Strategy, in particular in the area of competitiveness, a number of areas are identified in which the private sector of the Bank can have an important role to play. In order to enhance the role of the private sector in the area of environment, the Strategy proposes to initiate during the first year of its implementation the preparation of a formal evaluation of existing and new instruments for private sector participation, as well as a mechanism for coordinated actions among the private sector window (PRI), the Multilateral Investment Fund (MIF), the Inter-American Investment Corporation (IIC), and the Regional and Central Departments of the Bank.

In particular, new financial products will be identified to address specific private sector environmental opportunities. The types of projects which could be financed with existing or new private sector instruments are, for example: (i) potential forms of financial and other incentives for private sector companies to implement more stringent environmental and social controls and to invest in local community environmental and social programs, such as poverty reduction, health and education; (ii) use of capital markets to address environmental issues, such as environmental bonds, or guarantees for carbon credits; (iii) use of infrastructure funds to finance environmental projects such as renewable energy, solid waste management/disposal and waste water treatment for industrial parks; and (iv) private and public partnerships financed by IDB private sector and public sector departments to ensure all direct and indirect impacts are adequately mitigated and to help ensure a portion of the project benefits, such as private sector royalties paid to the government, are returned to local community investments and programs.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

IMPLEMENTATION PLAN

The Integrated Plan for Strategy Implementation, incorporates the priority actions described in this chapter and establishes target and specific activities, as well as responsibilities and implementation time-frameworks. The environmental priority actions require various activities to be carried out within a three year period (2003–2005). Some of these activities may be undertaken under current budgetary allocation, while others could be supported by trust funds or partnerships. Activities that may require a reallocation of administrative resources include, for instance, the strengthening of Bank capacity to monitor performance indicators, to develop technical guidelines and to improve the overall process of programming and execution.

The Environment Strategy will be implemented within the Bank's existing organizational framework. Several actions proposed are already being carried out, and need to be further systematized and coordinated. Nonetheless, some others are new and/or require internal strengthening and capacity building. Furthermore, there is a need to strengthen processes based on greater internal coordination efforts for which Bank management should send clear signals and incentives.

In terms of fostering the principles and priority areas of Bank support, as described in the fourth section, the implementation of the Strategy relies on allocating financial and nonfinancial resources in the context of the Bank's agreed pipeline on country by country and regional basis. In this regard, Bank loans and technical assistance will continue to promote specific environmental projects that can make significant contributions to enhance and protect the natural resources base and environmental quality, while contributing to achieving poverty reduction and sustainable economic growth goals. Furthermore, the Strategy foresees that all of the projects financed by the Bank in different sectors will have a clear environmental sustainability dimension, which should spur a broad array of new environmental initiatives.

The Bank is well equipped to foster sustainable development objectives and environmental management, as proposed in the fourth section, particularly through its new flexible lending instruments (i.e., innovation loans, multi-phase program loans, and preparation facility loans), which make it possible to insert the environmental dimension into broad development processes in a flexible manner. Moreover, as the Bank has recently been granted direct access to full scale project resources from the *Global Environment Facility (GEF)*, this financing instrument should be an effective tool to advance regional and global environmental issues in the region. In addition, the Emergency Reconstruction Facility, which has become a sector facility for loans that provides financial support for disaster prevention and mitigation, is closely tied to actions involving good practices in environmental and natural resources management.

From the private sector perspective, the financial instruments of the Multilateral Investment Fund (MIF) will continue to be essential to promote innovative environmental activities, particularly those that encourage the private sector to adopt eco-efficient processes and technologies. Similarly, the *Private Sector Department* (PRI) and the Inter American Investment Corporation, as stated before in this chapter have the potential to enhance their role and financing of various environment related operations.

Nonreimbursable technical cooperations, through trust funds of donor countries, as well as the fund for C and D countries (i.e., those with relatively slower economic development), and partnerships, make it possible to finance specific environmental initiatives. Nonetheless, these resources are relatively limited. Among the current instruments that can support specif-

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

ic aspects of the Environment Strategy are: *The Netherlands/IDB Partnership on the Environment, the Netherlands/IDB Partnership to Promote the Water Agenda in Latin America and the Caribbean; and the Regional Environmental Partnership for Central America involving the IDB and the Swedish International Development Agency (SIDA)*. In each case, the areas of support result from agreements and shared interests with the donors.

The importance of inter-agency coordination. Implementation of the Strategy also depends on the alliances and coordinated efforts that the Bank makes with other institutions, particularly with bilateral donors and multilateral financial agencies. The Bank will strengthen and continue collaborating with international financial institutions, exchanging information associated with the processes of environmental management. In particular, the Bank will continue participating and contributing to harmonization efforts, seeking points of convergence among the multilateral banks for co-financed projects, training, preparing environmental impact assessments and strategic environmental evaluations and studying opportunities for green procurement in these institutions. The Bank also will continue supporting specialized technical and policy bodies, such as the Forum of Ministers of the Environment of Latin America and the Caribbean.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

MONITORING, EVALUATION AND PERFORMANCE INDICATORS



The monitoring and evaluation of the strategy will be performed through indicators at two levels: (a) those related to the countries' sustainable development objectives, framed within the priority actions or areas described in the fourth section; and (b) those related to the implementation of the strategy in terms of the Bank's internal work and procedures, as described in the fifth section. The indicators to be monitored and evaluated will be grouped into three types: product indicators, outcome indicators, and impact indicators.

Product indicators: These indicators measure the Bank's activity in the area covered by the Strategy, in terms of the products delivered such as: number of loans, technical assistance provided, number of studies produced, events, reports, guidelines, etc. These indicators normally have been incorporated in the Bank's environment annual reports.

Outcome indicators: These will be obtained from the evaluation of Bank operations.

Impact indicators: At this level, the intention is to measure progress in achieving the objective of the Strategy. In this regard, it will be of interest the progress made in the areas defined in the fourth section, and in turn in reducing poverty and increasing conditions for sustainable economic growth. It is clear that the impact of Bank operations cannot be isolated from the country's overall development initiatives, in which the Bank is one among many actors.

To establish impact indicators, it is necessary to consider the known relationships between problems and their causes, starting always from a baseline or starting point and an ideal or desirable framework as a basis of comparison. Not enough data and capacity are presently available, either within the Bank and the borrowing member countries, to universally do this. Therefore, in the fifth section of the Strategy it is proposed to build up these capacities and it is recommended that Bank projects contribute to collect baseline information using a consistent methodological framework. In addition, Bank programs should also strive for countries to develop their own capabilities to systematically monitor impacts and links between environmental and natural resources management and poverty reduction and economic growth.

Within the overall Bank framework to promote development effectiveness, the Environment Strategy recommends building capacities and methodologies to measure and report product, outcome and impact indicators, in the specific context of project design and execution. Following the two fundamental priority areas for this strategy (i.e., environmental governance and policy development/incentive framework), the Bank will seek to develop indicators in the context of the programming exercises with each country. This process should define and characterize the current status of environmental governance and environmental policy development and evaluate changes and developments in those areas. Given that the implementation of the Environment Strategy is expected to contribute to achieving poverty reduction and sustainable economic growth through actions that are implemented across the four Bank priority areas, the indicators to be reported

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

will follow the priority areas recommended in the fourth section.

Impact indicators linked to Modernization of the State. Relevant indicators will be related to the following categories: (i) stage of development and capacities of institutions with primary responsibility for environmental management; (ii) conditions for civil society participation; (iii) development of regulatory frameworks, with special reference to capabilities for monitoring, oversight and enforcement; (iv) effectiveness of policies and economic incentives that affect natural resource use and environmental quality; (v) quality of environmental information available for decision making.

Impact indicators linked to Competitiveness. Relevant indicators linking environment a and competitiveness will consider the following categories: (i) the state of natural capital (quality and availability), as it relates to specific programs and projects and key resources under consideration (e.g., water, biodiversity, forest, soil, marine resources, etc); (ii) environmental instruments, norms and procedures to facilitate foreign and domestic private investment; (iii) private sector participation in environmental related investments; (iv) level of countries' preparedness to participate in environmental global and regional markets, with special reference to carbon mitigation as well as biological and genetic resources. Special attention will be given to indicators such as environmentally adjusted GDP and genuine domestic savings.

Impact indicators linked to Social Development. Relevant indicators will be developed and monitored considering the following categories: (i) health and environment, with special reference to mortality and morbidity rates linked to environmental factors, both in rural and urban settings; (ii) sustainable rural development, in terms of income indicators and quality of natural resources, with special reference to conditions of quality of life among small farmers and rural communities; (iii) preservation of socio-cultural wealth and biodiversity, with reference to needs and well being of indigenous groups; and (iv) physical vulnerability to natural disasters, with special reference to needs and conditions of poor and marginalized groups.

Impact indicators linked to Regional Integration. Key indicators that link the Environment Strategy with regional integration include: (i) strength and capabilities of regional environmental institutions; and (ii) availability and degree of application of regional environmental procedures, standards, norms and policies.

Monitoring in the context of Millennium Development Goals. As stated in the fourth section, in the context of developing Country Strategies references will be made as to how each country is advancing to meeting the MDGs. In terms of the MDG's there are three categories involving environmental indicators, which need to be followed as part of the four links described above: (i) *reversing the loss, waste, and degradation of natural resources*, with links to competitiveness and regional integration(goals and indicators must be specified for forest cover, biodiversity protection, energy efficiency, and CO_2 emission reductions); (ii) *improving access to sources of safe and clean water*, with links to social development(indicators on water coverage); and (iii) *improving living conditions in marginal areas*, with links to social development (indicators for sanitation coverage and security of land tenure).

The actions identified in the fifth section will be evaluated in terms of the specific activities that were implemented, products achieved, results obtained and impacts with regard to improved Banks internal work and effectiveness. The evaluation of the Environment Strategy will be carried out five years after its approval.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub



Areas of Action for the Bank and their Relation to the Sustainable Economic Growth and Poverty Reduction Strategies

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
1. Environmental Governance and Modernization of The State	**Effective Mainstreaming of Environmental Policies and Regulations to Facilitate Sustainable Development**	**Effective Social Inclusion and Participation in Environmental and Natural Resource Issues**
Objective: Develop and consolidate a framework for environmental governance, that is transparent, participatory and effective for preserving the natural capital and the quality of the environment.	*Objective:* Establish credible and widely accepted institutional and regulatory frameworks to internalize environ-mental dimension in economic programs and activities.	*Objective:* To empower local communities, indigenous communities, and the poor in decision making process regarding the environment and natural resources.
• Strengthen institutions and policy framework	• Support to central and local governments through environmental institutional development, policies and programs. Support intersectoral coordination, particularly in the areas of economic development, public finance and infrastructure.	• Promote capacity building for local environmental management and effective mechanisms for community participation.
• Strengthen regulatory frameworks	• Strengthening functions for monitoring, oversight compliance and conflict resolutions. Set clear norms stan-dards, procedures and guidelines to guarantee environmental quality of public and private investment.	• Support rural local governments and small municipalities to adopt and implement regulations.
• Environmental management instruments	• Develop of effective instruments for environmental management, including incentive and market based instruments. Improve access to environmental information at all levels to facilitate decision making.	• Development of local instruments to empower local governments and communities to manage and protect their natural resources. Promote public awareness and education.

(continued on the next page)

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
2. Environmental and Natural Resources Management and Competitiveness	**Enhanced Value of Natural Resources and Ecological Services as Natural Assets**	**Opportunities for Improved Development and Well Being of Local Communities**
Objective: Enhance and manage on a sustainable basis the natural assets as source of development, competitiveness and well being.	*Objective:* Foster the region's competitiveness by protecting and managing their environmental attributes and rich natural base.	*Objective:* Create conditions for increased income opportunities and productivity, on sustainable basis, in rural and indigenous communities.
• Enhancing the sustainable use of natural capital	• Promote the conservation of natural resources as a source of economic growth and competitiveness and increase investment for protecting ecological functions and environmental services.	• Promote the sustainable use of natural resources to be managed by rural communities and indigenous groups, and the protection of biodiversity of which they depend.
• Facilitating investments and market development and Private sector participation in environmental related activities	• Promote access to environmental markets, certification mechanisms, information and procedures to enable private sector investment. Promote clean technologies and processes and involve the private sector in providing services for environmental management.	• Provide assistant to small farmers, communities and grass root organizations to develop markets opportunities and sustainable income. Strengthen rural and urban micro-enterprises develop environmental initiatives.
• Environmental markets	• Tap opportunities to access markets for global environmental services such a carbon sequestration.	• Make indigenous groups and rural communities participants/beneficiaries of initiative such as biogenetic research and development.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
3. Environment, Natural Resources Management and Social Development	**Increased Quality of Life and Long Term Labor Productivity/Protection of Human and Physical Capital**	**Increased Quality of Life for Poor and Marginalized Groups**
Objective: Establish the close link between social development and environmental management and prioritize environmental related activities to improve social conditions.	*Objective:* Reduce environmental degradation that in turns affects human and physical capital, therefore avoiding loses and costs to the economy.	*Objective:* Improve the quality of life of poor and marginalized groups who suffer the direct consequences of environmental degradation.
• Health and environment	• Reduce incidence of illnesses and mortality associated to environmental health, and improve overall quality of life.	• Target the poor and marginalized people in urban and rural areas to improve their environment and health conditions, as they are the groups directly affected by degraded environments.
• Rural development and natural resources	• Foster rural development initiatives based on the quality and sustainable use of soil, water, and forest resources.	• Target initiatives to small farmers, hill side agriculture, upper watersheds, and communities around protected areas to adopt sustainable development.
• Indigenous communities and their natural resources	• Make indigenous communities active beneficiaries of markets, such as ethno tourism, biotechnology.	• Assure the respect for cultural traditions.
• Physical vulnerability to natural disasters and environmental risks	• Adopt adequate land use planning, risk management, and prevention mechanisms to protect human lives and vital physical infrastructure.	• Prioritize the poor and marginalized groups that are vulnerable to disasters in prevention initiatives. Promote environmental awareness and education.

(continued on the next page)

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Areas of Action	Relationship to the Sustainable Economic Growth Strategy	Relationship to the Poverty Reduction Strategy
4. Environment and Regional Integration	**Development of Economic Opportunities from Regional Public Goods and Environmental Services**	**Development of Opportunities of Poor and Economically Depressed Trans-boundary Regions**
Objective: Foster regional economic integration, by recognizing that countries are naturally integrated by shared environments that need to be managed regionally.	*Objective:* Promote sustainable economic development on a regional scale, on the basis of shared natural resources that need to be protected and managed adequately.	*Objective:* Protect and enhance the economic basis and means of livelihood to border populations and communities, that are often the most marginalized.
• Regional environmental institutions	• Strengthen regional institutions to effectively address and coordinate issues of environmental management, including regional investments, free trade negotiations, and harmonization of key environmental standard and procedures.	• Promote capacity building for local environmental management and effective coordination mechanisms among border communities and indigenous groups, based on consultation processes to address needs of border communities.
• Investments in regional environmental public goods	• Promote regional sustainable development in critical, transboundary areas, particularly in watersheds and biological corridors.	• Develop regional environmental public goods, with wide community participation and agreements between groups and stakeholder, with impact on poor areas.
• Environmental quality for regional infrastructure	• Adopt sound strategic environmental impact assessment to guarantee economic, social and environmental viability of large infrastructure projects.	• Include consultation process to address needs of border communities and empower them to be effective participants and beneficiaries of projects.

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Copyright © by the Inter-American Development Bank. All rights reserved.
For more information visit our website: www.iadb.org/pub

Graphic production of the book:
Inside layout design by Design Unit, ITS/GSV
Printing by the Printshop Unit, ITS/GSV.
Cover design by Studio Grafik, Inc.



INTER-AMERICAN
DEVELOPMENT BANK

1300 NEW YORK AVENUE, NW
WASHINGTON, DC 20577
USA

www.iadb.org

Copyright © 2007 Inter-American Development Bank. All rights reserved.