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VISION 2025
REINVEST IN THE AMERICAS: A DECADE OF OPPORTUNITY

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Acronyms

BoD	Board of Directors
BoG	Board of Governors
CABEI	Central American Bank for Economic Integration
CAF	Development Bank of Latin America
CRF	Corporate Results Framework
DEO	Development Effectiveness Overview
GCI	General Capital Increase
GDP	Gross domestic product
GRF	Grant Facility
HMICs	High and Middle-Income Countries
IBRD	International Bank for Reconstruction and Development
IDB	Inter-American Development Bank
IDBG	Inter-American Development Bank Group
IDB-9	Ninth General Capital Increase
IIC	Inter-American Investment Corporation
IMF	International Monetary Fund
INV	Investment
LAC	Latin America and the Caribbean
LGBTQ+	Lesbian, Gay, Bisexual, Trans, Queer, plus
LTFP	Long-term Financial Projections
MDB	Multilateral Development Bank
NGOs	Nonprofit Organizations
OC	Ordinary Capital
OCDE	Organization for Economic Co-operation and Development
PBL	Policy-based Loan
PPP	Public-private partnership
RAC	Risk Adjusted Capital
SACP	Stand-alone Credit Profile
SDGs	Sustainable Development Goals
SDL	Special Development Lending
SDP	Special Development Program
SG	Sovereign Guaranteed
SLL	Sustainable Lending Level
SMEs	Small and mid-size enterprises
S&P	Standard & Poor's
USA	United States of America
USD	United States Dollar
WB	World Bank

I. Executive Summary

- 1.1. The IDB Group is the leading development institution in Latin America and the Caribbean. Its mission, as originally stated in the Agreement establishing the Inter-American Development Bank in 1959, is to contribute to accelerating the economic and social development of the developing member countries in the region. To achieve this, the IDB Group needs to foster economic growth, help reduce poverty and inequality, improve governance, foster climate change mitigation and adaptation, promote gender equality and inclusion, and respond to crises, natural disasters, and other socioeconomic challenges. Vision 2025 presents the opportunities and ways the IDB Group can effectively meet the needs of the region.
- 1.2. Latin America and the Caribbean faces the most dire socio-economic crisis in the 61-year history of the IDB. The region is currently at a critical juncture as a result of the COVID-19 pandemic, long-standing structural weaknesses, and recent natural disasters, all of which further amplified preexisting development gaps. In 2020, GDP declined by 7.4 percent and total employment by 10 percent, with 44 million people in the region expected to have fallen into poverty and 52 million to have exited the middle class (Acevedo et al. 2020). Most countries will not return to pre-pandemic levels of GDP until 2023 or real income per capita levels until 2025 (Pieknagura, Roldós, and Werner 2020). In 2021, the region must find a way to address the consequences of a “triple sudden stop” that includes major disruptions in human mobility, trade, and capital flows.
- 1.3. The past year proved to be transformational for the region. Countries are now faced with only two paths—one of recovery, reinvestment, and renewed opportunity, or one of continued economic deterioration that will have devastating socioeconomic effects for decades to come. If the issues facing the region are not addressed, Latin America and the Caribbean risks another “lost decade” like that of the 1980s, with stalled development, worse governance, and deteriorating security. However, amid accelerated digitalization and a readjustment of global value chains, the COVID-19 pandemic has also presented the region with an unprecedented opportunity to expand markets, generate employment, create more efficient and effective educational and social services, foment renewables, and turn the centuries-old aspiration of regional integration into reality.
- 1.4. Vision 2025 outlines the new Administration’s priorities to advance implementation of the Institutional Strategy for the 2021–2025 period and respond to the challenges that Latin America and the Caribbean faces and will continue to face in the years to come,¹ and a path to come out of the crisis with more sustainable growth and resilience. In 2019, world leaders called for a Decade of Action to accelerate SDG progress, emphasizing the need to mobilize greater financing, strengthen institutions, harness science, technology and innovation and other critical activities to leave no one behind. With the significant human and economic toll COVID-19 is taking on the region, taking decisive action to leave no one behind and overcome the region’s mounting challenges is more urgent than ever.

¹ The Institutional Strategy was approved by the IDB Board of Governors in 2010 under the Ninth General Increase in the Resources of the Inter-American Development Bank (IDB-9) with the overarching objectives of fostering sustainable growth and reducing poverty and inequality. The strategy was first updated in 2015 for the period 2016–2019. The Second Update to the IDB Group Institutional Strategy (AB-3190-2) was approved by the Board of Governors in July 2019 covering the period beginning in 2020.

- 1.5. The endeavor to establish priorities for IDB Group's work is centered on advancing the region's efforts toward the Sustainable Development Goals (SDGs) during the first half of the Decade of Action, as the Bank remains committed to ensuring that Latin America and the Caribbean meets them by 2030.
- 1.6. The new Administration's approach to designing the IDB Group's vision includes presenting its focus on achieving sustainable and inclusive economic growth, identifying a pathway to achieve those goals with an emphasis on five clear opportunities, and presenting a value proposition to strengthen the IDB Group's ability to execute.
 - i. **Work towards sustainable and inclusive economic growth-:** (i) reactivate the productive sector; (ii) promote social progress; and (iii) strengthen good governance and institutions. A critical element to define success in moving towards these objectives in the coming years will be the ability to seize the opportunities the crisis has created.
 - ii. **Identify a Pathway to accelerate the recovery:** This pathway includes focusing on immediate opportunities: (i) regional integration, by supporting the reconfiguration of global value chains and integration initiatives; (ii) the digital economy, by facilitating access and creating the capacity to embrace digital technologies and foster innovation; (iii) support for small and mid-size enterprises (SMEs), by generating the conditions to maximize the private sector's contribution to the recovery; (iv) climate change, by helping countries foster resilience, mitigation, and adaptation; and (v) gender equality and diversity, by empowering women and vulnerable populations who bear most of the burden of the health and economic crisis. A renewed focus on gender and climate change will allow the IDB Group to further promote sustainable and inclusive growth.
 - iii. **Present a Value proposition:** To overcome these unprecedented challenges, the new Administration proposes a tailored value proposition that encompasses (i) a review of the IDB Group's current resources; (ii) balance sheet optimization; (iii) capital adequacy ratios; and (iv) an infusion of new capital. In addition, the new Administration will seek to identify efficiencies in processes, project design, and monitoring and evaluation to optimize results. Partnerships will play a key role in leveraging more resources to complement existing ones and meet the region's needs. An enhanced governance structure will foster results delivery. Furthermore, improved, and continuous monitoring efforts will permit to better track progress toward targets. As part of the new Administration's focus on results, Management will enhance tools to monitor progress on CRF indicators and conduct baseline measurements for priority areas where information is lacking. Strengthened supervision of project execution and results will inform decisions, ensure transparency, and foster impact.
- 1.7. The implementation of this Vision will allow the Group to play a key role in (i) the provision of a sound COVID-19 response to include equitable access to vaccines; (ii) economic growth rates of at least 3 percent per year that might lead to lower poverty rates and a more

resilient middle class; (iii) higher levels of formal employment;² (iv) better integration into international goods and capital markets;³ (v) stronger innovation and entrepreneurial ecosystems;⁴ (vi) climate change resilience;⁵ and (vii) greater access for women to financial markets (IDB 2020I).⁶

- 1.8. The new Administration will work with governments, civil society, and the private sector, as well as with the development community, to build a more prosperous, inclusive, and sustainable region. The opportunity cannot be lost upon the Bank. Figure I presents a visual summary of Vision 2025.

² The existing literature reports that (i) a 1 percent increase in GDP in Latin America and the Caribbean would generate 1 million additional formal jobs; (ii) workers with a secondary education in a productive formal company will increase their salary by 27 percent after seven years, while the same workers in an informal enterprise will see a salary increase of only 8 percent; and (iii) cutting labor taxes in half could boost productivity and increase formal employment by 25 percent.

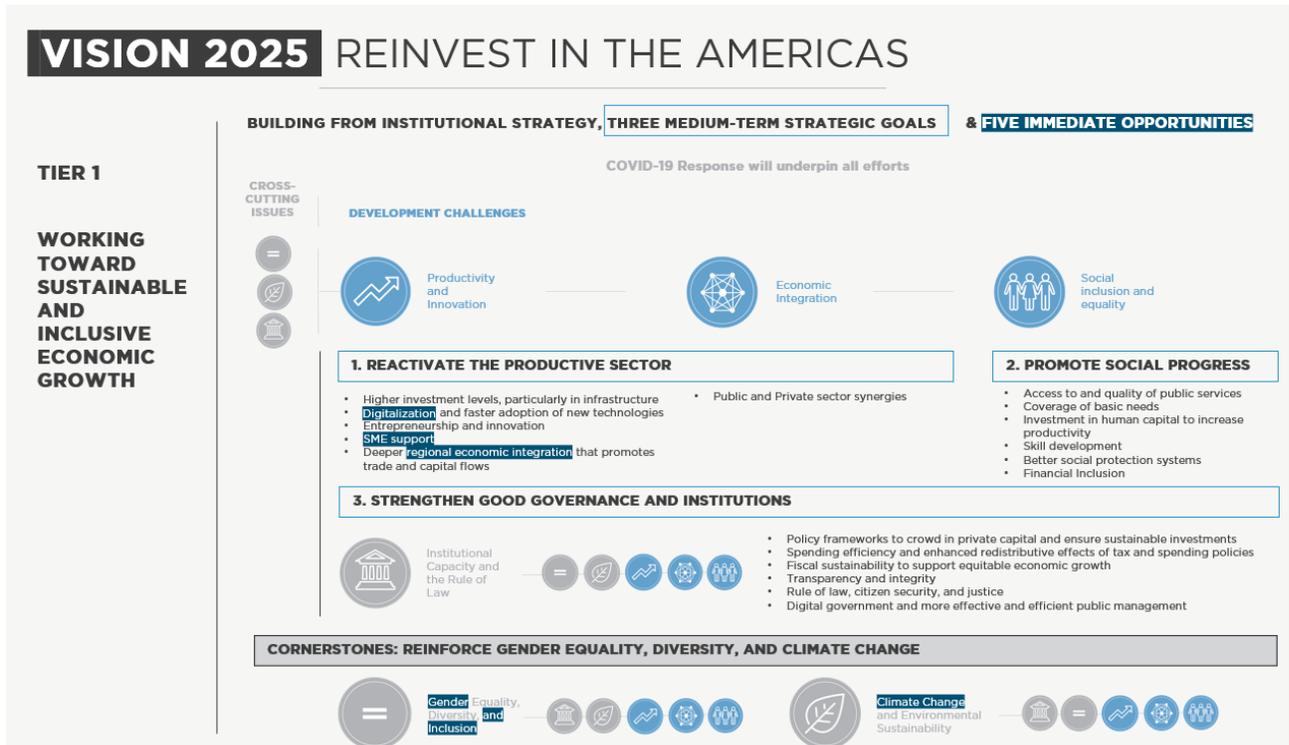
³ The existing literature reports that (i) a 56 percent tariff reduction accelerated the region's average annual per capita income growth between 0.6 and 0.7 percent and boosted trade from 20 to 40 percent of GDP; (ii) the expansion and convergence of the more than 33 existing preferential agreements in Latin America and the Caribbean could increase intraregional trade by 11.6 percent; and (iii) a 10 percent reduction in freight costs could boost exports from the region to the United States by 30 percent on average.

⁴ The existing literature reports that (i) a 10 percent increase in fixed broadband penetration is associated with a 3.2 percent increase in GDP per capita, and (ii) a 15 percent reduction in service delivery costs through better use of available digital technologies could increase GDP in Latin America and the Caribbean by 6 percent in 10 years.

⁵ The existing literature reports that (i) damage caused by climate change could cost the region US\$100 billion annually by 2050; (ii) air pollution alone causes 5 percent of premature deaths annually in Latin America and the Caribbean, with welfare losses that exceed 2 percent of GDP; and (iii) investing in resilience measures can multiply the socioeconomic benefit of infrastructure investments by up to six times over.

⁶ The existing literature reports that (i) a 10 percent reduction in the regulatory costs of firm entry increases the number of formal firms relative to the size of the labor force by 1 percent; and (ii) a 10 percent increase in regulatory quality raises the innovation rate by 1 percent.

Figure 1. Vision 2025. Reinvest in the Americas



VISION 2025 REINVEST IN THE AMERICAS

TIER 2
STRENGTHEN THE IDB GROUP FINANCIAL RESPONSE CAPACITY AND VALUE PROPOSITION

SCALING UP FINANCIAL CAPACITY

- Balance sheet optimization
- Efficient and increased resource mobilization
- Coordination with national and international financial institutions and partners
- Capital adequacy limits
- Capital Increase-10

ENHANCING VALUE PROPOSITION

- Updating the existing financial offering
- Efficiency
- Utilize knowledge
- Pursue public-private synergies
- Monitor and measure results

II. The Context⁷

- 2.1. Prior to 2020, Latin America and the Caribbean already had anemic growth rates that averaged 0.1 percent in 2019, exacerbated by social unrest in several countries. This unrest occurred in the face of governments that increased public spending to an average of 6 percent of GDP over the past two decades. Even with that public spending increase, however, there were limited improvements in the quantity and quality of services that the region's emergent but fragile middle class expected and demanded (IDB 2018a). As a result, that middle class took to the streets in 2019–2020 to demand higher-quality service delivery and government responsiveness.
- 2.2. At 18 percent of GDP, investment in Latin America and the Caribbean is well below that in other regions, particularly high-growth Asian economies, and is not highly productive. While the region should be investing at least 5 percent of GDP in infrastructure, its current investment is less than 3 percent of GDP (Serebrisky, Suárez-Alemán, Pastor and Wohlhueter, 2020). As a result of this low level of investment in infrastructure, populations in most countries have deficient access to basic services such as water, sanitation, transportation, and electricity. Likewise, countries have fallen behind in investing in robust innovation ecosystems that are fundamental for the transformation of the productive sector. Expenditures on research and development, and on innovation more broadly, have decreased over the last decade, even as such expenditures have accelerated in high-growth economies.⁸
- 2.3. Latin America and the Caribbean has low levels of human capital. The capacity of health systems in the region to respond to the COVID-19 pandemic has been poor, in part because of inadequate investments in recent decades. In education, 65 percent of Latin American and Caribbean students do not achieve minimum competency in math on Program for International Student Assessment tests, compared to 16 percent in Korea, 7 percent in Singapore, and 2 percent in four Chinese cities (Beijing, Shanghai, Jiangsu, and Zhejiang). Human capital is critical for economic growth and poverty reduction, and by one estimate more than half of the growth deficit in Latin America vis-à-vis East Asia can be explained by Latin America's low levels of educational achievement (Hanushek and Woessmann 2012).
- 2.4. These challenges are compounded by high vulnerability to climate change and increasing incidence of natural disasters. Latin America and the Caribbean is the second most disaster-prone region in the world (UNCTAD 2020b).⁹ The region is particularly vulnerable to the effects of climate change such as sea-level rise, natural disasters, and changing precipitation and temperature patterns that threaten water security, jeopardizing health, productivity, and food-producing crops. The two hurricanes in 2020 that hit Central America, the fiercest storms in years, affected more than 4.5 million people, compounding the

⁷ This document draws on the findings of the IDB Group diagnostics about the challenges and opportunities in a post-COVID-19 world, as well as IDB sector frameworks. For more information see Annex I.

⁸ Navarro, Benavente, and Crespi (2016) outline the main constraints that limit the development of a high-growth innovation ecosystem in the region, including a lack of investment in research and development, the need to further develop entrepreneurship, venture capital, and private innovation finance, and the need to improve infrastructure for science and technology.

⁹ Over the 2000–2019 period, Latin America and the Caribbean was hit by 1,205 disasters affecting over 150 million people.

pandemic and its economic slump. This is a reminder of the region's vulnerability to climate change and the threats it poses to pursuing a sustained growth strategy.

- 2.5. The region remains trapped in the production of traditional goods and services, with little gains in terms of producing higher-value-added and more complex products. Manufacturing, mining, agriculture, construction, and tourism and other traditional services continue to dominate most economies.⁹ SMEs, which constitute over 90 percent of firms in the region and generate 61 percent of employment, are highly exposed to the economic cycle and access to credit and liquidity shortages (IDB 2020i). Backward participation in global value chains represents 18 percent of exports, while in Asia and the European Union this rate reaches 32 percent and 40 percent, respectively (Blyde and Trachtenberg, 2020). This economic structure has led to low growth and vulnerability to shocks, including those stemming from the COVID-19 crisis. Investing in digital transformation and productive development reforms is critical to enable the opportunities of the Fourth Industrial Revolution.
- 2.6. The fiscal space in Latin America and the Caribbean to support growth is limited. Over time, high levels of current expenditure that is often inefficient have accounted for a large proportion of public spending, leaving little space for productive public investment. Moreover, the room for countercyclical fiscal policy is narrow. Given the high deficits countries will have in 2020 because of lower revenues and fiscal stimulus expenditures, debt overhang is a risk for many countries. The average debt-to-GDP ratio is expected to reach 80 percent by the end of 2022, up from 58 percent in 2019.
- 2.7. The region performs poorly in terms of implementing the rule of law and controlling corruption, eroding public trust and deterring long-term private sector investment (IDB 2020n).¹⁰ According to the World Economic Forum's, Global Competitiveness Index for 2017–2018, corruption is one of the main factors affecting the region's business climate, together with government bureaucracy. Citizen trust has remained low in the region, with only 22 percent of Latin Americans expressing trust in their governments in 2018, according to the Latinobarometro survey. Latin American and Caribbean countries have scored below their peers from the Organization for Economic Co-operation and Development (OECD) over the last 20 years in terms of government effectiveness (IDB 2020n). In addition, the region accounts for 37 percent of homicides worldwide despite having less than 9 percent of the world's population (UNODC 2019), which results in an economic cost of crime and violence of 3.5 percent of GDP on average (Jaitman 2017). Twenty-five percent of private sector firms consider crime the most significant constraint to doing business in the region (World Bank 2018).
- 2.8. Therefore, Latin America and the Caribbean came into the COVID-19 pandemic in a weak position, with subdued productivity, strained fiscal accounts, and long-standing structural bottlenecks that constrained its ability to achieve higher economic growth rates that would translate into social gains. Just prior to the pandemic, reports on progress toward the SDGs

⁹ The productive portfolio of the region remains largely dependent on traditional goods and services, reflecting a stagnant economic structure and amplified vulnerability. The region is still characterized by a high concentration of exports, with commodity exports accounting for between 10 and 60 percent of GDP. Tourism represents between 33 and 75 percent of total exports in countries such as The Bahamas, Barbados, Jamaica, Belize, and Haiti.

¹⁰ Additionally, Mauro (1995) finds that corruption acts as a disincentive to investment by reducing profitability, increasing uncertainty, and endangering companies' reputations, thus creating additional costs for business.

cited critical lags across the region, delays that COVID-19 has only exacerbated (ECLAC, 2019).¹¹

- 2.9. In 2020, the region is estimated to have lost the equivalent of 39 million full time employees (ILO, 2021), and informality is expected to have increased from 56 to 62 percent of total employment (Arboleda et al. 2020). Women have been particularly affected, as they have lower rates of labor force participation and formality than the rest of the population. Progress achieved since 2000 in terms of expanding the middle class and reducing poverty will have reverted. The consolidated middle class shrunk by 7.7 percentage points, from 36.2 percent in 2019 to 29.3 percent in 2020, and poverty is estimated to have increased from 24 to 31 percent over that same period. This includes an expected rise in extreme poverty from 12.1 to 16.2 percent (Acevedo et al. 2020).
- 2.10. By the end of 2020, the region had recorded 507,604 COVID-19 deaths. Although it has less than 9 percent of the world's population, the region has accounted for more than 25 percent of all COVID-19 deaths. These socioeconomic setbacks call for urgent action from multilateral institutions, including the IDB Group, to stop these reversals and chart the path for member countries toward a more resilient recovery with a particular focus on job creation.
- 2.11. In 2021, the countries of the region will face macroeconomic, fiscal, social, institutional, and health challenges, and will have difficult choices in terms of responding to the needs of their populations under tighter fiscal constraints. As these pressures grow, higher risk of volatility and instability in the region might further deepen the social and economic reversals in 2020 and make recovery even more difficult.
- 2.12. Going forward, two scenarios emerge – one of recovery and renewed opportunity, and the other of continued economic deterioration that will have serious socioeconomic effects for decades to come. Unless prompt and effective action is taken, Latin America and the Caribbean will be defined by another “lost decade” like that of the 1980s, with stagnant economic activity, recurrent social conflict, worse governance, and deteriorating security.
- 2.13. To overcome existing challenges, foster sustainable growth, and reduce poverty and inequality, Latin America and the Caribbean will require additional external financing, innovative resource mobilization, and technical assistance to enact reforms that boost productivity, improve living standards, strengthen institutions, and generate larger and better investment. Re-igniting private sector activity will be a leading factor in the region's recovery from the most significant crisis in recent history. The present context provides an opportunity to break with the past and pursue a new inclusive-growth-oriented strategy. The ability of governments to devise and implement adequate policies will contribute to economic progress and social stability. As the IDB Group has reacted quickly to help the region mitigate the economic and social fallout during the COVID-19 emergency, it remains a strategic partner as countries move ahead toward the recovery, with a particular focus on job creation.

¹¹ See also <https://www.unsdsn.org/sdg-index-and-monitoring>

III. Opportunities for Latin America and the Caribbean Over the Next Decade

- 3.1. The current crisis has exacerbated development gaps and poses the risk of significant and long-term effects on the region that include higher debt levels, worsening poverty, and greater inequality. The IDB Group must play a critical role in promoting a pro-inclusive growth plan to strengthen economies, meet larger inclusion and equity targets, and ensure improved governance and effective measures to improve fiscal sustainability in a context of deteriorated economic conditions. The social consequences of the crisis are serious. To overcome them, countries should prioritize job creation, investment in human capital (Hanushek and Woessmann 2012), removal of barriers to financial inclusion, the delivery of better-quality services to its citizens, and protection against cyclical shocks. Some jobs have been permanently lost due to transformations in several industries, while new occupations with different skill requirements are becoming available. The resulting skill mismatches and unemployment have pushed people out of the middle class and into poverty. Pension systems only cover a small fraction of the elderly population, monetary transfers to vulnerable groups are subject to leakage to the non-poor, and unemployment insurance is scarce. Therefore, the IDB Group must take steps to accelerate job creation, foster labor formalization, strengthen social security systems, guarantee access to and improve the quality of education, health, energy, water, sanitation and public transport services, promote skill development, and reform social spending to promote formality, while also considering the inclusion of diverse groups (indigenous peoples, Afro descendants, persons with disabilities, LGBTQ+ individuals) and migrants.
- 3.2. Investment will be a driver of future growth. Investments in technology, entrepreneurship, and venture capital, as well as in a more vibrant innovation ecosystem, will result in the rapid creation of new, dynamic firms and in the expansion of existing ones. More and better infrastructure will promote private sector investment and growth and foster climate change goals both in terms of mitigation (especially in energy and transport) and resilience. Average growth rates could increase by a cumulative 3.5 percentage points over a period of 10 years in countries with the right investment and investment-friendly climates. Improved infrastructure services can also reduce poverty and inequality, as they have the potential to increase income for the average citizen by a range of 2.8 to 5.4 percent (Brichetti, Cavallo and Serebrisky 2020). Productivity, transparency, and effective accountability are intrinsically connected. Institutional quality and respect for the rule of law are instrumental in improving the delivery of public services as well as creating a business climate that incentivizes investment and supports private sector development (Americas Business Dialogue 2018). The IDB Group must help countries expand investment in sustainable infrastructure and infrastructure services.
- 3.3. The policy space for countercyclical fiscal policy has been reduced dramatically since the increases in expenditure and indebtedness resulting from the response to the pandemic and natural disasters. In the years ahead, governments will have to keep their access to financial markets open to prevent a drastic correction in fiscal balances that could derail the recovery. Macro-fiscal institutions will have to be strengthened and medium-term macroeconomic policies should re-orient priorities to ensure fiscal sustainability and rebuild buffers when possible, while at the same time supporting long-term growth. The IDB will continue to strengthen its coordination with the International Monetary Fund (IMF) to accompany countries facing economic distress and advise authorities on the appropriate actions to strengthen macro-fiscal and debt management. In addition, the IDB should stand ready to work with governments to help them restore their fiscal space, embark on fiscal reforms and

modernization efforts of their tax administrations, and avoid potential sovereign debt problems.

- 3.4. The public sector will be a main actor in the implementation of public policies to create an enabling and de-risked environment for the productive sector to seize these opportunities and foster its contribution to development objectives. Given their fiscal constraints, governments at both the national and subnational levels will need to become more transparent, agile, and efficient in reallocating expenditure, first towards preserving health and economic spending during the pandemic, and then pivoting to pro-inclusive-growth expenditures that spark the recovery and sustain higher growth with better social coverage.¹² However, reallocation will not be enough, and additional fiscal space will be needed to finance reforms without putting sustainability at stake. Currently, inefficiencies in transfers, wages, and procurement are equivalent to 4.4 percent of GDP (Izquierdo et al. 2020). The IDB will support countries in implementing civil service reforms, revamping social benefits, and adopting more digital solutions to enhance public sector performance—including digital fiscal management and simplification and digitalization of government procedures—to enable those savings, opening space for pro-inclusive-growth spending. Revenue collection also must be increased. The IDB will help countries strengthen their revenue administration agencies to reduce evasion, as well as design better revenue policies that foster formality and widen the tax base by reducing preferential treatments.¹²
- 3.5. The COVID-19 crisis opens new opportunities that should be seized and given particular emphasis within the new pro-inclusive growth strategies. As the pandemic has accelerated digitalization and technological change (McKinsey & Company 2020) and reshaped the configuration of global value chains (UNCTAD 2020a), the new Administration proposes that the IDB Group leverage the opportunities in these areas to jumpstart a private-sector-led recovery. Translating the potential dividend of these opportunities into long-lasting economic growth calls for higher levels of investment and innovation, more efficient, effective, and transparent institutions, and policy reforms to foster a thriving environment for private initiatives and quality citizen-centered public service delivery, with a view to help reactivate the productive sector, promote job creation, and mitigate the socioeconomic reversal caused by the crisis.
- 3.6. **The COVID-19 response.** While the region is still going through the pandemic, the priority is to tackle the health crisis and limit its social and economic costs. Strengthening the health system, increasing the availability of testing and tracing mechanisms, and promoting broad and rapid access to the vaccine is critical not only for health, but also for economic recovery. Limiting the severe losses of income for poor and informal households is a humanitarian imperative. Likewise, avoiding the destruction of the productive base of the economy and of the human capital of children, young people, and workers is key to ensuring a more rapid recovery once the outbreak is contained.
- 3.7. **Regional integration.** The crisis has offered many prospects for greater regional integration and reinvestment. In recent months, supply chains have revealed their fragility and risks, leading to an increased diversification of sources of inputs and markets and to a shortening or “nearshoring” of supply chains. As companies transfer business processes to others in nearby regions to benefit from proximity, nearshoring can deliver new opportunities for

¹² Subnational governments have increasing importance in the provision of public goods and services, which doubled on average during the past three decades to reach 25 percent of consolidated public expenditure (see IDB 2018f).

¹² Revenue policies include not only tax policies but also non-tax revenue policies such as royalties, revenues from government-owned assets, and user fees, among others.

investment in Latin America and the Caribbean. The IDB Group should support the regionalization of global value chains to unleash their potential to increase productivity and employment in the region, as these chains promote investments in traditional manufacturing, infrastructure, mining, technology, entrepreneurship, and venture capital. The latter, paired with the development of more vibrant innovation ecosystems and know-how through a skilled labor force, can result in the rapid creation of new, dynamic firms and in the expansion of existing ones.¹³ Increased and improved sustainable infrastructure and digital connectivity will promote private sector investment and growth and foster climate change goals both in terms of mitigation (especially in energy, transport, and sanitation) and resilience (especially strengthening water security). These initiatives should be complemented by efforts to boost international trade that pull in global capital flows, such as foreign direct investment to take advantage of potential nearshoring prospects. Facilitating processes and demonstrating agility and commitment to diversify economies can encourage the private sector to engage in large-scale and long-term projects that will produce badly needed increases in aggregate productivity.¹⁴ The IDB Group can foster (i) higher and more efficient investment in infrastructure and connectivity by applying principles of environmental, social, financial, and institutional sustainability; (ii) the consolidation of efficient commercial architecture by promoting interventions that deepen the economic integration and international insertion of countries of the region; (iii) necessary policy reforms and institutional strengthening to improve transparency, integrity, and the ease of doing business;¹⁵ and (iv) policy dialogue to enable infrastructure integration.

- 3.8. **The digital economy.** The recent convergence of digital technologies has sparked innovations with powerful impacts across industries that will likely result in a new industrial revolution. Digital online platforms could increase global GDP through improved productivity, greater employment, and higher labor market participation. Up to 540 million people could benefit from online job intermediation platforms by 2025 (IDB 2019a). A 10 percent increase in broadband penetration is associated with a 3 percent increase in GDP per capita and a 2 percent increase in productivity (Garcia Zaballos and Lopez-Rivas 2012).¹⁶ Online government procedures cost, on average, 5 percent of the cost of in-person, on-paper procedures, leading to great efficiency gains and savings in public management and service delivery (Roseth et al. 2017d).¹⁷ More broadly, digital government can strengthen the capacity of governments and thus the quality and delivery of public services and access to them.¹⁸ If proper taxation of the digital economy is in place, this sector could generate growing public revenues and a level playing field among digital and non-digital firms, as well as among international and national digital service providers.

¹³ The reconfiguration of global value chains can also support or facilitate more inclusive schemes to integrate women-owned or women-led firms, or firms owned or led by diverse groups (indigenous peoples, Afro descendants, persons with disabilities, LGBTQ+ individuals, and migrants) into these supply chains. The IDB Group has played a role and can continue to do so in this area.

¹⁴ Since the 1990s, declining productivity in Latin America and the Caribbean has subtracted 0.1 of a percentage point from growth every year. This stands in contrast to Emerging Asia, where productivity has boosted growth by almost 2 percentage points per year (Izquierdo and Parrado 2020).

¹⁵ Critical determinants of the ease of doing business are requirements for business registration and for paying taxes.

¹⁶ Connectivity in Latin America and the Caribbean is limited. Only 13 percent of the population has access to fixed broadband and 65 percent to mobile broadband (compared to 33 percent and 96 percent in OECD countries). Among rural households, 95 percent (120 million people) do not have access to the Internet. Broadband costs in the region are around 10 percent of household income, while they are below 2 percent in OECD countries, according to data from the IDB's [Digilac](#) platform.

¹⁷ Latin American and Caribbean governments manage, on average, more than 2,000 procedures.

¹⁸ Only four Latin American and Caribbean countries are among the top 50 countries in the UN digital government ranking (United Nations 2020).

- 3.9. The digital economy is emerging in Latin America and the Caribbean, and to ensure the region's medium- and long-term prosperity countries need to be responsive to the opportunities and risks associated with disruptive technologies. Successfully adapting and harnessing their transformative effects would pay long-term dividends for economies in terms of growth, innovation, and social inclusion (IDB 2018b). It will be critical that governments devise specific and complementary programs to support digitalization to exploit its social, economic, and productive potential (IDB 2020k),¹⁹ increase the resilience of the productive sector, and develop the skills workers need in the medium term.
- 3.10. Digitalization can also spur growth and innovation through what is known as the “orange” or “creative” economy. Increasing digitalization, combined with entrepreneurship, sets the stage for a thriving creative industry. Creative industries have taken advantage of the increasing number of Internet users, as it makes it easier to match supply with demand at lower costs (IDB 2018c). Also, innovation is a lynchpin of an orange economy, which takes advantage of new content-driven value chains. These investments can create greater demand for state-of-the-art technology, offer new job opportunities for small businesses that tap into the cultural heritage of countries, and artisanal-based economies (Benavente and Grazi 2017).
- 3.11. As has become even more evident, the ability of both the private and public sectors to thrive in this new context will depend on their capacity to embrace these new digital technologies. These technologies can foster better and more equal opportunities for citizens (employment and access to services such as education or health), a more productive, innovative, and resilient private sector, and more effective, efficient, and transparent governments. Leveraging digital technologies is key to boosting employment and growth and enhancing social inclusion. The IDB Group can help countries develop an enabling digital ecosystem that addresses several key areas, including (i) increasing investment, especially in connectivity infrastructure; (ii) designing appropriate regulatory frameworks; (iii) investing in human capital; (iv) adjusting public procurement systems and processes; (v) leveraging disruptive technologies; and (vi) supporting innovative startups.
- 3.12. **Support for small and mid-size enterprises.** The private sector will need to contribute to the recovery by creating jobs, promoting growth, materializing new digital-based economic opportunities, and reducing poverty and inequality. Larger firms have been successful in accessing external financing, but SMEs, which have the biggest share of employment, have had trouble finding financing. Restrained capital flows and widespread downgrades underline the challenges the private sector will face in finding appropriate financing sources due to market failures and heightened risk aversion. SMEs are most likely to be affected and unable to seize opportunities without proper access to a skilled labor force and adequate financing, especially to long-term credit to fund innovation and digitalization and to expert support. Women-owned SMEs already faced barriers to access to finance before the crisis and are expected to be disproportionately affected by it, compounded by the fact that women are often primary caregivers. As innovative business models that take advantage of new technologies are emerging and consumer behavior patterns are changing, access to finance and technical assistance will be crucial for SMEs to adapt and stay competitive. IDB Invest and the IDB Lab can help businesses, especially SMEs, navigate the crisis and consolidate their contribution to the recovery. The IDB can seek to

¹⁹ Among the urban population in Latin America and the Caribbean, 71 percent have connectivity options, compared to only 37 percent of their counterparts in rural areas. This 34 percentage-point gap undermines the immense social, economic and production potential of the rural population. In total, 32 percent of the Latin American and Caribbean population – that is, 244 million people – have no Internet access.

(i) reduce market distortions; (ii) deploy its financial instruments as incentives for the financial system to allocate resources toward more attractive projects; and (iii) promote entrepreneurship and innovation to help boost aggregate productivity.

- 3.13. **Gender and Inclusion.** Latin America and the Caribbean is one of the most unequal regions in the world, and that applies to gender inequality as well. Women earn less while working more hours than men. Although very entrepreneurial, women have less access to credit. The COVID-19 pandemic has exposed and even widened these gaps. Empowering women and other vulnerable populations who bear most of the burden of the health and economic crisis will result in a much faster recovery from the COVID-19 shock (IDB 2020m). With these challenges in mind, the IDB Group will design incentives to promote programs primarily focused on gender equality and women's empowerment to co-finance women-based initiatives, seek ways to increase financing that supports women-led businesses and foster policies that increase access to credit for women's entrepreneurial efforts, and improve access to financial systems for women across all economic strata in the region. As part of these efforts, the IDB Group will reinforce its mainstreaming efforts and challenge itself to find ways to develop a gender-based business pipeline of projects and to be a leader in supporting innovative and inclusive projects that promote the economic empowerment of marginalized groups.
- 3.14. **Climate change.** The sizable investments needed to help Latin America and the Caribbean recover from the COVID-19 pandemic—especially investments included in stimulus packages—can and at the same time must help the region confront the pressing challenge of climate change. These investments should help build resilience to climate-induced increases in sea levels, storm intensity and frequency, heat stress, water shortages, agricultural losses, and disease outbreaks, all of which have enormous costs. Climate change damage in the region could cost US\$100 billion annually by 2050 (Vergara et al. 2013). Moreover, the International Labour Organization estimates that 2.5 million jobs in Latin America and the Caribbean could be lost to heat stress alone by 2030 (Kjellstrom et al. 2019). These investments should also support the development of green infrastructure and sustainable land-use projects to mitigate climate change and boost GDP and employment while recovering from the COVID-19 crisis and increase productivity. Conservation and sustainable use of biodiversity will be an integral component of these investments. The IDB Group will also provide knowledge and innovation to support nationally determined contributions and long-term strategies as part of the process to set policies towards becoming low-carbon economies and be aligned with the Paris Agreement. By continuous mainstreaming climate-change across all its activities, the IDB Group should be a leader among multilateral development banks on the issue of climate resilience, and mitigation and adaptation must become a critical pillar of financing.
- 3.15. Governments that are effective in implementing broad reform agendas and take advantage of the emerging opportunities can regain citizens' trust, which is fundamental to foster capital spending, enhance growth, reduce inequality, and promote private sector participation. Societies that grow faster and are equitable and environmentally sustainable will have more resources to support efforts to forge the political consensus needed to carry out critical reforms. If these pro-inclusive-growth strategies are successfully implemented, Latin America and the Caribbean stands to reverse its stagnation in per capita income and mark the beginning of the region's long-awaited process of converging with the developed world in terms of social and economic development.

IV. Looking Forward: Vision 2025

- 4.1. Multilateral institutions have a crucial role to play in setting Latin America and the Caribbean on a more inclusive and sustainable development path to not only accelerate the recovery from the pandemic shock but also to ensure sustainable economic growth, greater social equity, strengthened governance and institutions, resilience to climate change, and a reduced carbon footprint. The IDB Group is strategically positioned to partner with countries and clients in advancing toward the achievement of the SDGs and national development priorities through development financing, technical assistance, knowledge, and partnerships to increase impact and mobilize additional resources to accelerate country progress.²⁰
- 4.2. As the IDB Group ramps up its call to close development gaps and increase productivity in the region, it will be crucial to leverage both the public and private sectors. The IDB can help the public sector strengthen and de-risk the business climate, while IDB Invest and IDB Lab can partner with the private sector to deploy capital and knowledge at scale, managing the impact of these efforts on fiscal accounts while strengthening the engines of the recovery.
- 4.3. Vision 2025 presents the priorities of the new Administration aligned with the IDB Group's Institutional Strategy.²¹ It proposes a two-tier approach to the Group's activities in the region. The first tier aims at achieving three medium-term strategic objectives to induce sustainable and inclusive economic growth. The Group's work to achieve these goals must emphasize the catalytic and transversal role that regional integration, the digital economy, and support for SMEs support can play in pursuing such growth. The second tier focuses on scaling up financing and strengthening the IDB Group's value proposition.

Tier 1: Working towards Sustainable and Inclusive Economic Growth

- 4.4. The urgency to support a robust recovery offers the IDB Group the opportunity to strategically focus attention on three medium-term strategic goals that can foster the region's long term development objectives.
- 4.5. **Reactivate the productive sector** in a way that encourages (i) higher investment levels with better quality, particularly in infrastructure and digital connectivity; (ii) digitalization and faster adoption of new technologies;²² (iii) entrepreneurship and innovation, including in creative industries (the "orange economy"); (iv) SME support; (v) deeper regional economic

²⁰ The IDB Group is constantly monitoring and reporting on its contribution to SDG (www.iadb.org/sdgs).

²¹ The Institutional Strategy was approved by the IDB Board of Governors in 2010 under the Ninth General Increase in the Resources of the Inter-American Development Bank (IDB-9) with the overarching objectives of fostering sustainable growth and reducing poverty and inequality. The strategy was first updated in 2015 for the period 2016–2019. The Second Update to the IDB Group Institutional Strategy (AB-3190-2) was approved by the Board of Governors in July 2019 covering the period beginning in 2020.

²² The Second Update to the IDB Group Institutional Strategy (2019) states: "Although all of the IDB Group entities have continuously supported science, technology and innovation, the speed of the 4th Industrial Revolution calls for a renewed approach. In recent years, IDB Group has incorporated a strengthened awareness of the possibilities of innovation and technology across many sectors. This trend needs to be reinforced and mainstreamed" (paragraph 4.2).

integration that promotes trade and capital inflows;²³ and (vi) public and private sector synergies to enhance the role of the private sector as a driver of growth and a partner in implementing development agendas.

- 4.6. The IDB Group can drive and fund the expansion of private-sector-led mechanisms to facilitate access to financing by firms, especially SMEs. These can include partnerships with bank and non-bank financial institutions, as well as anchor companies. The IDB Group can also help in designing and funding policies to (i) invest in entrepreneurship, develop the innovation ecosystem, and encourage a more conducive business climate; (ii) increase investment rates and efficiency, including through sustainable infrastructure and digital connectivity investment that enhances private sector growth; (iii) create incentives and promote the conditions required to accelerate the adoption of new technologies and digitalization; (iv) promote the emergence of dynamic companies with inclusive and sustainable new business models that could become engines of economic growth; (v) advance innovation-intensive areas such as creative industries; and (vi) expand women's economic opportunities by increasing labor force participation, closing income and gender gaps between men and women, and improving women's access to more productive and better-paid jobs and occupations.
- 4.7. As the IDB Group promotes regional integration to reactivate the productive sector, it can support the public and private sectors in capitalizing on the opportunities of economic integration, such as emerging nearshoring prospects. To achieve this objective, the IDB Group should promote interventions and policies for (i) more efficient and secure customs-logistics services, transportation interconnectivity, energy integration, and shared-use infrastructure; (ii) high-quality trade promotion and investment services customized to meet the needs of the region's enterprises; (iii) access to finance to help exporters insert themselves into the new global value chains and share in the benefits of trade integration with their local value chains; and (iv) the expansion and harmonization of intra-regional trade agreements to make value chains operational in the region.
- 4.8. A sustainable and inclusive recovery will require good governance in the private sector to make it an effective partner for growth. IDB Invest has played and can play a role in generating inclusive schemes to integrate women-owned or women-led firms, or firms owned or led by diverse groups (indigenous peoples, Afro descendants, persons with disabilities, LGBTQ+ individuals, and migrants), into supply chains. IDB Invest can complement public sector reforms by (i) setting high standards for environmental, social, and governance safeguards and non-financial risk management for the projects it finances; (ii) reinforcing its role as a standard setter in the countries and markets where it operates; (iii) enhancing the standards and capacity of advisory services provided to clients; and (iv) developing knowledge products that demonstrate the financial benefits of best-practice standards to firms. IDB Lab can help recognize scalable solutions to build private sector resilience by (i) identifying new economic opportunities that can become future engines of growth; (ii) fostering supply chain innovations with an increased focus on nearshoring; (iii)

²³ The Update to the IDB Group Institutional Strategy (2015) argues that “beyond trade and political agreements, economic integration in Latin America and the Caribbean still lags compared to other emerging regions in a wider sense affecting the productivity and competitiveness of individual countries and the Region as a whole because they hamper its small and medium-sized enterprises (and its firms in general) from developing or joining value chains and engaging in more sophisticated, higher value-added production” (paragraph 2.11). It also states that policies should aim to insert firms into value chains given that it “is a beneficial process, not only for large and medium enterprises but for SMEs, as it allows firms to exploit their comparative advantages at finer stages of production and helps the Region diversify its export basket” (paragraph 3.7).

achieving higher cost competitiveness through faster adoption of new technologies and increased digitalization; (iv) accelerating local innovation and entrepreneurial ecosystems; (v) testing new business models that leverage innovation to deliver essential services to vulnerable populations; (vi) promoting the testing and adoption of green technologies; and (vii) fostering digital skills development to exploit new opportunities and promote job creation.

- 4.9. **Promote social progress** in a way that fosters (i) access to and the quality of public services, in particular health, education, water, sanitation, and electricity; (ii) coverage of basic needs, such as food security and housing; (iii) investments in human capital to increase labor productivity; (iv) skill development; (v) better social protection systems; and (vi) financial inclusion.²⁴
- 4.10. To fight poverty and lower inequality, the IDB Group should prioritize its activities to (i) improve access to and the quality of health and education services; (ii) close infrastructure gaps to ensure access to affordable water, electricity, and public transport; (iii) guarantee food security and access to housing; (iv) improve workers' access to good-quality employment and relevant learning and training opportunities tailored to expand skills and diversify job opportunities for all populations groups; (v) formalize labor markets, including new forms of self-employment and employment through digital platforms and reforms of social transfer systems to increase incentives for employment formality; and (vi) put in place safety nets that mitigate potential risks to workers' income and consumption, including unemployment insurance, using digital identification and modern payment systems. These activities will be geared toward the protection of the rights of marginalized groups, such as persons with disabilities, migrants, indigenous people, and Afro-descendants, LGBTQ+ individuals and others historically excluded.
- 4.11. **Strengthen good governance and institutions**²⁵ that aim to put in place (i) policy and institutional frameworks to crowd in private capital and ensure sustainable investments;²⁶ (ii) spending efficiency and enhanced redistributive effects of tax and spending policies, and fiscal sustainability to support equitable economic growth; (iii) transparency and integrity; (iv) the rule of law, citizen security, and justice; and (v) digital government and more effective and efficient public management.

²⁴ The Second Update to the IDB Group Institutional Strategy (2019) states: "LAC is often seen as the developing region that has made the most progress on gender equality—however the region continues to face three important challenges: (i) women continue to face barriers in labor markets, including a labor force participation rate that is on average 20 points lower than men's and significant wage and earnings gaps; (ii) women are severely underrepresented in leadership positions in both the public and private sectors, with significant negative consequences for productivity, profitability, and the quality of decision-making; and (iii) women in the region continue to be affected by violence; approximately 30 percent of women, for example, have suffered violence at the hands of an intimate partner" (paragraph 4.11).

²⁵ The Second Update to the IDB Group Institutional Strategy (2019) states: "The IDB Group has supported countries and clients in institutional strengthening, including improving the delivery of public services, facilitating strong business climates, and addressing citizen security challenges, among other interventions. However, [...] both grand and petty corruption in the private and public sectors are undermining productivity, trust in government and threatening to erode the region's economic well-being" (paragraph 4.20).

²⁶ The Update to the IDB Group Institutional Strategy (2015) states: "Along with the government, the private sector has an essential role to play in improving productivity and generating sustainable growth, as it fosters innovation and job creation. Thanks to its convening power and its reputation as a long-term trusted partner with technical knowledge, the Bank is able to bring the public and private sectors together and engage them in joint ventures, such as public-private partnerships or long-term concessions, to share risks and broaden investment horizons" (paragraph 3.11).

- 4.12. The IDB's role is to promote sound public sector institutions and policies that translate into more effective, efficient, and transparent governments that address citizen needs and foster robust and equitable growth that integrates gender and sustainable development perspectives. The IDB can support enhanced fiscal policy management and orderly fiscal consolidation in the region at both the national and subnational levels by helping to craft medium-term reforms that (i) re-establish the credibility of fiscal policy and strengthen macro-fiscal and debt management; (ii) strengthen policy frameworks to crowd in private capital and ensure sustainable investments; (iii) promote redistributive tax and spending policies, (iv) increase revenue collection by strengthening tax administration agencies and reforming tax policies to widen the tax base and foster growth and formality; (v) promote a tax system that fosters efficiency; and (vi) foster both technical and allocative spending efficiency, which is crucially lacking.
- 4.13. Another key area of IDB support is transparency and integrity through reforms aimed at improving the quality of institutions and regulations, expanding access to information, and strengthening the role of the agencies responsible for promoting public and private sector integrity.²⁷ Such reforms should step up the fight against corruption, furthering alignment with international transparency and integrity standards²⁸ and the leveraging of digital technologies to enhance access to information and citizen participation. The IDB can support improvements to the rule of law through the strengthening of citizen security and justice institutions contributing to reducing vulnerability of at-risk populations,²⁹ promoting social inclusion, and fostering a more favorable investment climate. The IDB can also propel digital transformation across all government levels and sectors to enhance the quality, access, and delivery of public services, as well as the effectiveness, efficiency, and openness of public management in line with citizens' needs. Likewise, fostering the framework enabled by digital transformation is crucial to putting in place sound governance and institutions, a regulatory framework, digital talent, and digital infrastructure and tools as the articulated, cross-cutting, and sustainable foundation of digital transformation.
- 4.14. **Reinforce Gender Equality, Diversity, and Climate Change.** The Institutional Strategy's cross-cutting issues of gender equality and diversity and climate change will be cornerstones of Vision 2025. As part of the Institutional Strategy, these cross-cutting issues are integrated across all the work the IDB Group carries out in Latin America and the Caribbean. In addition to the advances to date, the new Administration aims to achieve more significant progress on each of these cross-cutting issues, further strengthening their mainstreaming and considering their potential to develop new and innovative business lines that contribute to the goals outlined above. As a result, the IDB Group continues to work on the design of a climate change facility that can foster a climate change pipeline, encouraging green and resilient infrastructure and leveraging the region's abundance of the minerals and metals critical for this energy transition, in order to help countries embark on a path to become low-carbon economies and align with the Paris Agreement. The pandemic has had

²⁷ For a private sector perspective, especially related to integrity in value chains, see Americas Business Dialogue, (2018).

²⁸ Examples of these standards include the Follow-up Mechanism for the Implementation of the Inter-American Convention against Corruption (MESICIC), the G20 Anti-corruption Working Group Action Plan, the Responsible Business Conduct and Anti-Corruption Plan of the Business 20 (B20) Summit, the Extractive Industries Transparency Initiative (EITI), the World Economic Forum's Partnering Against Corruption Initiative, the Open Government Partnership, and the international standards of the Organization of Latin American and Caribbean Supreme Audit Institutions (OLACEF standards).

²⁹ For example, by providing opportunities for at-risk populations through social violence prevention programs targeting youth that increase possibilities for insertion into the labor market attachment and reduce the attractiveness of criminal activity and the use of violence.

a disproportionate impact on women, as well as minorities which calls attention to the importance of the work of the IDB Group in those sectors. As a result, the new Administration will assess and reexamine progress to date to meet internal goals for financing, address gaps, identify new opportunities for investment, and work with partners in the private sector to advance and achieve even more ambitious goals. The IDB Group should be at the frontier of climate financing and gender-diversity investment.

Tier 2: Strengthening the IDB Group Financial Response Capacity and Value Proposition

- 4.15. The IDB Group must be well equipped to help Latin America and the Caribbean in its recovery. As the gap between the region's long-term needs and the IDB Group's ability to meet them widens, there is a risk that the Group will be unable to respond and lose its competitive edge in the region. The IDB Group must seek to remain the partner of choice for its borrowing member countries. The Group's response to the COVID-19 crisis by scaling up support in a fast and effective way proved the critical role it can play and its ability to revamp its operational tempo to work with stakeholders. As a result, lending levels by the IDB increased by 9 percent and disbursements increased by 40 percent in 2020 over 2019. Maintaining and expanding this response capacity requires a multipronged solution that includes improved and agile processes, adequate products, cost-saving initiatives, and a capital increase.
- 4.16. The IDB Group's value-added for the region is linked to its ability to achieve better economies of scale, draw on a strong degree of specialization, leverage government dialogue, and jumpstart reforms for inclusive growth. The Group is a recognized impact-driven leader with a track record of creating and disseminating knowledge, promoting innovative financing solutions, setting standards, achieving progressively more ambitious impact goals, crowding in private investment, providing direct financing (equity/quasi-equity and debt) to impactful early ventures and companies addressing key development challenges, and drawing new investors to the region.
- 4.17. Efforts to enhance the IDB Group's value proposition create incentives for countries to engage with the Group, such as by pairing financing and technical assistance that stands apart from other development actors or even commercial banks in the region. The IDB is competitive because its lending is a stable source of funding at more affordable rates than what markets can offer to most borrowing member countries and can serve the private sector at competitive market rates and with additionality. Providing resources for long-term investments helps support structural reforms that are clear and attainable, as well as growth agendas that commercial banks or capital markets might avoid because of risk considerations. Where countries can access capital markets, the IDB Group provides value added through technical cooperation and knowledge sharing, and crowds in the private sector.
- 4.18. The IDB Group will pursue two complementary strategies to underpin its ability to address the region's unparalleled challenges: (i) a scaled-up financial capacity; and (ii) an enhanced value proposition to deliver results in a timely manner. Both are crucial to help borrowing members withstand emergency contexts in the short run, and to overcome the constraints that hinder the pursuit of a sustainable and pro-inclusive-growth agenda in the long run.
- 4.19. **Scaling up financial capacity.** The IDB Group's current ability to effectively address the development challenges of Latin American and Caribbean countries is restricted by the limits of its financial capacity. Several options are available to address this issue:

- a. Balance sheet optimization.³⁰ To make maximum use of available funds, the IDB can further explore balance sheet optimization, through:
- i. Portfolio, first-loss guarantees from highly rated shareholders to reduce risk-weighted assets and at the same time provide for additional loss-absorption capacity to be leveraged by the IDB.
 - ii. Portfolio exchanges across multilateral development banks to ease capital adequacy constraints (i.e., Exposure Exchange Agreements).
- b. Efficient and increased resource mobilization.³¹ The IDB Group must keep finding ways to increase mobilization and catalyze private financing in line with the pillars outlined in the IDB Group's Mobilization Roadmap 2020-2023, by:
- i. **Enhancing mobilization from existing and prospective traditional and non-traditional partners**, including expanding partnerships with bilateral and multilateral financiers, corporate and institutional private investors, and philanthropic foundations, in part to leverage private and IDB capital.
 - ii. **Promoting domestic resource mobilization**,³² by scaling up efforts to help countries maximize their own resources through policy advice, technical assistance, and capacity building to strengthen regulatory frameworks, develop local capital markets that allow private enterprises to tap the resources of domestic institutional investors, and create incentives to foster investment-friendly environments.
 - iii. **Catalyzing private financing**. The IDB Group will continue exploring the use of credit enhancement products, and innovative instruments such as guarantees, B-bonds and blended finance, among other tools that facilitate the crowding-in of private capital, with the goal of de-risking projects, and addressing market failures to make riskier operations commercially viable.
- Across these pillars, these efforts will require:
- Developing innovative financing instruments that leverage IDB capital, such as guarantees, securitization, loans to enhance countries' credit ratings, and blended finance, among others.
 - Identifying private co-financing targets via public sector loans and the use of guarantees.
 - Coordinating efforts across the IDB Group to increase mobilization targets through the deployment of funds under administration, third party private co-financing, and public co-financing.
 - Enhancing programming and project origination activities and creating internal incentives.
- c. Coordination with national and international financial institutions and partners. The IDB Group will participate in Country Platforms as tools to achieve effective coordination

³⁰ For more detail see Annex II.

³¹ For more detail see Annex III.

³² Initiatives to promote domestic capacity for tax planning, collection, and combat tax evasion are not contemplated as a part of the IDBG Resource Mobilization Roadmap. These initiatives are led by the Fiscal and Financing Management Division within the priorities established in the Updated Institutional Strategy.

across development partners to work as a group,³³ and to help countries prioritize their key development issues and engage development financiers (including non-traditional donors and the private sector) around those issues. The IDB Group can help countries purpose these platforms to pursue specific development goals and effectively involve the private sector in these endeavors. Given the critical need to attract much larger volumes of private risk capital, the IDB Group can de-risk investment environments and projects. Supporting the adoption of current best practices in governance and regulation, the IDB can foster a conducive environment for private investment. Coordinating across country platforms using guarantees and/or subordinated capital can de-risk specific projects and facilitate financing and technical expertise for deals that otherwise would not be feasible to finance through commercial banks. By doing so, the IDB Group, jointly with other international financial institutions and national development banks, can open the door to private investment in emerging markets for country-owned projects and help achieve a measurable positive impact, especially in the least-developed sectors and countries.

- d. Capital adequacy limits. As lending capacity is constrained by both risk-based metrics and the limit on the debt-to-equity ratio, in addition to the options for further balance sheet optimizations outlined earlier, the Bank plans to review this policy to assess its appropriate level. The review of the debt-to-equity limit will be critical to right-size capital needs. Initial estimates indicate that for every 0.1x increase in the debt-to-equity limit, the reduction in capital requirements is approximately US\$700 million.

While the above-mentioned efforts will help the Bank maximize its financial impact in the region, they are likely to be insufficient, as financing requirements are expected to increase because of the long-term impact of the COVID-19 pandemic and the persisting large investment gaps that limit growth prospects. A capital increase will allow for expanding the Bank's ability to better meet the need to (i) help countries in emergency contexts in the short run, in coordination with the IMF and World Bank; and (ii) contribute over the long term to financing investment gaps and helping pursue the reforms needed to reignite growth towards the SDGs.

- e. Capital increase-10.^{34,35} The new Administration envisions the need for additional capital for the IDB Group, as 2021 presents a new set of challenges for Latin America and the Caribbean that were not forecast over the past five to 10 years. As a result, the Group will see greater demand for support from clients and must stand ready to assist with the combination of a complete set of tools and resources, and with an increased capacity that will enhance its agility to respond. Additional capital will leverage IDB Group lending

³³ The use of Country Platforms is recommended in the report of the G20 Eminent Persons Group on Global Financial Governance (EPG) to coordinate financial institutions operating in an individual country.

³⁴ Due to the legal and financial separation between the institutions of the IDB Group (IDB, IDB Invest and IDB Lab), capital increase aimed at the public sector must be approved by the IDB Board of Governors, unlike a capital increase oriented to the private sector, which must be approved separately by the Board of Governors of the Inter-American Investment Corporation (IIC). Regarding the IDB Lab, funding for both operations and administrative expenses currently derives from a single pool of funds contributed by donor countries.

³⁵ The IDB Lab's funding for both operations and administrative expenses derives from a single pool of funds contributed by donor countries. The IDB Lab had an initial contribution in 1993 for US\$1.2 billion, and two replenishments in 2007 and 2017 for US\$500 million and US\$300 million, respectively. At the request of the Governors, the IDB Lab is in the process of rethinking its funding model to achieve greater sustainability beyond 2023, when its resources will be depleted. This is an IDB Group effort that began with an informal discussion with donors about a model that could rely less on periodic donor contributions and more on resource mobilization, self-generating income, and transfers from the IDB Group (MIF/GN- 252).

over the next decade that will be critical for the region's recovery. More resources will help the Bank (i) improve financial sustainability; (ii) assure a better response to countries' needs; (iii) increase flexibility in the use of resources for project finance and strategic funding for projects aligned with priorities and the Update to the institutional Strategy; (iv) serve as a buffer for unforeseen crises; and (v) support Venezuela's reconstruction plan (see Box 1). More resources for IDB Invest and the IDB Lab³⁶ will help steer private sector capital towards an inclusive and sustainable recovery by (i) providing private sector financing for a sustainable and equitable recovery; (ii) scaling up the crowding-in of private finance through core mobilization; (iii) financing infrastructure; (iv) expanding equity investments to support institutional priorities such as digitalization and nearshoring; and (v) maintaining the capacity to respond to future crises as IDB Invest reaches its target capital adequacy ratio.

4.20. The region is facing serious fiscal constraints and limited absorption capacity in a context of larger financing needs. As borrowing member countries devise sustainable debt management strategies, a proper fiscal consolidation requires, first and foremost, a strong economic recovery. As governments take the lead to foster investment and help the private sector regain its confidence to invest, sound fiscal programs to support inclusive and sustainable growth will be needed to avoid a lost decade. In a context where debt service considerations and investment plans are paramount, the Bank can help countries analyze budget constraints and investment needs and prioritize areas with proven capacity to promote inclusive growth, consistently with national fiscal sustainability objectives. By so doing, the Bank can provide much needed financing with more certainty, at lower costs and longer maturities than the market to promote growth-enhancing strategies while advising authorities on medium-term reforms to foster fiscal sustainability. The efforts to enhance the IDB Group's value proposition aim to pair larger lending volumes with an array of products and financing alternatives that better responds to countries' needs in terms of result delivery and debt management objectives.³⁷

³⁶ See GN-3025. As agreed upon the approval of the third replenishment of the IDB Lab, a discussion on options to continue operating after 2023 has already started. One of the options under discussion includes income transfers from the IDB. If the Bank is required to make annual income or equity transfers to other entities or funds similar to those agreed upon in the Ninth General Capital Increase, then those transfers need to be included in the financial projections and will result in an increase in the capital required by IDB or a reduction in the sustainable level of approvals. If included, those transfers would need to remain (i) subject to the Agreement establishing the IDB, (ii) conditional upon the Bank complying with its capital adequacy policy mandate and other financial policies, and (iii) subject to yearly approval by the Board of Governors.

³⁷ For more detail see Annex IV.

Box 1. Support for a Future Recovery Plan in Venezuela

The magnitude and scope of the socioeconomic crisis in Venezuela are unprecedented. From 2013 to 2019, Venezuela's GDP contracted by around 70 percent, and at the end of 2017 the country entered a hyperinflationary process that has continued up until the present. As a result of the crisis, 5.5 million Venezuelans are living in other countries of the region. The COVID-19 pandemic has compounded this highly vulnerable situation (IDB 2020j).

The IDB will play a leading role in the recovery and reconstruction of Venezuela when conditions allow for such efforts. The IDB Group will be a central hub for coordination and planning with donors, governments, and the private sector because of its expertise and know-how. Recovery and reconstruction in Venezuela will be a multi-decade effort that will require the IDB Group to develop and refine a comprehensive program focused on near-term immediate needs and more long-term investments in reconstruction. Any plan will need to be sequenced to address social issues to improve the quality of life of the population and public service provision (electricity, water, and transport services) and must consider the likely return of a considerable proportion of the Venezuelans who have fled the country in previous years. This must be followed by a strategy to reestablish market rules, reduce hyperinflation, and make strategic investments in key sectors of the Venezuelan economy needed to jumpstart reactivation. Some of those sectors include energy, health, and support for small and mid-size enterprises. All of this will require a significant amount of financial and technical resources over time and call for extraordinary involvement by the International Monetary Fund, coordination with the World Bank, and levels of financing by the IDB Group that are beyond its existing capacity. These efforts will be complemented by the involvement of other actors such as international governments, bilateral donors, and the private sector.

Box 2. Migration challenges will continue in the region

Sudden and large-scale migration flows have created one of the great development challenges in the region in recent decades. These flows came from Venezuela, but not exclusively. With a marked acceleration since 2017, 5.5 million Venezuelans have settled in other Latin American and Caribbean countries especially in South America. This large-scale exodus captured international attention at the time, but the countries receiving these flows will need to continue to make considerable fiscal efforts to care for the migrants in the coming years. Returning migrants also represent important development challenges for their countries of origin. Bank estimates show that these return flows are currently even higher than intra-regional immigration in some of the northern Central American countries. Total emigrants from the Caribbean increased in the 2015-2019 period by 8%, from 9.4 million to 10.2 million. This emigration accounts for smaller numbers compared to other international flows, but in terms of the population of Caribbean countries, these totals represent some of the highest fractions in the world. Forty percent or more of the nationals of Suriname and Guyana reside abroad, and more than a quarter of the nationals reside abroad in the cases of Barbados and Jamaica. This coupled with the risks of climate change in that region and its consequences on migration place that sub-region as a key focus on migration.

The Migration Initiative was created in October 2018. The main objective is to respond to the regional crisis generated in the receiving countries due to the growing and sudden intra-regional migration flows, especially but not exclusively, from Venezuela. In May 2019, the Bank's Board of Executive Directors and Governors approved the extension of the use of the IDB's Grant Facility for up to \$100 million to allocate resources to countries receiving migration, of which \$55 million has already been invested and is expected to be fully invested by March 2021. In addition, the Migration Unit was created in 2020 reporting to the social sector. In September 2020, the Bank's Board of Executive Directors approved the Action Framework for Migration. The Action framework broadens the scope of work to comprehensively include the typologies of origin, destination, return and transit, in addition to defining the different areas of intervention and the proposed next steps, while maintaining the priority on countries C and D. The coming years will require the Bank to continue working on the issue, as the challenges and opportunities of migration are linked to other development issues (education, health, labor, housing, etc.) making it a cross-cutting development area that will require non-reimbursable resources, knowledge, and partnerships.

- 4.21. **Enhancing value proposition.**³⁸ To maximize support in a context of larger financial requirements, the IDB Group needs a concerted response to leverage new approvals, portfolio resources, and technical assistance, and to seek efficiency gains. It must also develop a knowledge agenda focused on supporting policies to promote sustainable and inclusive economic growth and development. At the same time, a systematic pursuit of public-private synergies will expand the contribution of the private sector to the recovery and long-term development prospects.
- 4.22. Improving the IDB Group's alignment with countries' needs requires, besides a modern management and organizational structure, enhancements along several dimensions:
- a. Updating the existing financial offering. To serve a client base that requires flexibility, the IDB Group needs to offer:
 - i. **A competitive and comprehensive set of products.** The availability of appropriate options in terms of maturities, currency, and debt management tools will cater to countries' evolving demand, help meet fiscal sustainability goals, and improve the IDB's market competitiveness.
 - ii. **Greater flexibility for crisis response.** Exploring options to deploy larger amounts of resources at a time of crisis will enhance the Bank's crisis-response capacity. This will be combined with an increased size of existing emergency instruments, such as Special Development Loans.
 - iii. **Expanded liquidity supply.** Proposals to increase liquidity supply will enhance the IDB's ability to attend unmet demand, foster the use of policy-based loans to better leverage much needed reforms to sustain recovery.
 - b. Efficiency. The new Administration is committed to quality over quantity in its operations. Better use of resources will enhance responsiveness, transparency, and accountability to all stakeholders, focusing on the following elements:
 - i. **Strategic use of technical cooperation.** A comprehensive response to governments and clients implies more strategic use of technical cooperation resources. This involves (i) reviewing the mechanisms to allocate the Ordinary Capital Strategic Development Program resources for technical cooperation operations to better integrate them into the programming process; (ii) pooling technical cooperation resources, with clear criteria for access, to ensure support for project preparation and alignment with country strategies; and (iii) using resources to foster pre-investment activities and opportunities for public-private partnerships (PPP) and private sector projects that will mobilize private financing, especially for infrastructure. This will result in greater ability and flexibility to align with country priorities and in increased attractiveness of IDB financial products by establishing a more direct link between lending and technical assistance.
 - ii. **Project design.** The preparation cycle, starting with design, needs to adapt and reduce average preparation times for low-risk operations while adjusting timelines according to the requirements of current policies, in particular the new social and environmental sustainability standards, for high-risk projects. Closer coordination between Managers both from Sector and Country Departments and Country

³⁸ For more detail see Annex V.

Representatives during the programming and preparation processes will be key to address local realities, ensure alignment with institutional priorities, provide opportunities to incorporate cross-cutting agendas such as gender and climate change, and deliver maximum development impact.

- iii. **Project monitoring and management.** The IDB must (i) adjust execution mechanisms to country realities, project complexity, and risks, and help improve implementation capacity; and (ii) establish seamless client connectivity for effective delivery of results.
 - iv. **Digital transformation.** The implementation of an IDB Group digital transformation plan using technology will reduce redundancies and streamline existing internal processes to achieve higher levels of efficiency, transparency, and accountability.
 - v. **Institutional governance.** The pursuit of a more agile and modern management structure will enhance internal coordination and progress towards shared goals, contributing to greater efficiency and transparency. An enhanced dialogue between Management and a more strategically focused Board of Directors will contribute to fostering decision-making, project implementation, and the delivery of results.
- c. Utilize knowledge and expertise. The IDB Group is a leading knowledge generator for the region. To maintain and improve this position, the IDB Group will scale up resources both from the regular budget and technical cooperation to:
- i. **Develop a Group-wide knowledge agenda.** Enhanced joint planning of knowledge products will help identify areas where (i) existing knowledge production can be improved to prioritize interventions with the biggest impact in terms of sustainable and inclusive economic growth and development; and (ii) new knowledge agendas need to be forged.
 - ii. **Foster knowledge to enhance the IDB's competitiveness.** Reinforcing the linkages between knowledge, technical assistance, and the lending program will provide a comprehensive response to countries. Better use of evaluation results, reaping knowledge from past interventions, will keep improving the design of future policies.
- d. Pursue public-private synergies. The pandemic and its consequences have underscored the need to bolster the pursuit of synergies across the IDB Group to ensure that efforts to contain the crisis are followed by a private-sector-led recovery. As enhanced public-private coordination will be at the core of the IDB Group's ability to deliver a comprehensive response to governments and clients, the challenge ahead is to strengthen:
- i. **Coordination to deliver comprehensive country strategies.** Efforts to deepen and systematize public-private collaboration at the strategic level will enhance the development and implementation of country strategies, as well as policy dialogue.
 - ii. **Incentives to foster operational synergies.** Strengthening the Country Representatives' mandate to mobilize skills across the public and private sectors to create diverse teams to design operations and technical assistance will foster the Group's capacity to respond to multidimensional challenges. Creating incentives through performance evaluation processes to form project teams across the Group and continue coordination around opportunities for PPPs will ensure effective upstream work and timely participation in policy dialogue.

- e. Monitor and measure results. Management is focused on a clear results-oriented approach to project design, execution, and supervision to strengthen impact.
 - i. **Enhance the use of Corporate Results Framework.**³⁹ The IDB Group will strengthen the monitoring tools and business processes associated with its Corporate Results Framework, with a focus on those indicators for which targets have been established for the 2020-2023 period. Monitoring tools and processes will emphasize transparency throughout the IDB Group, increased granularity in data capture and reporting, and agility in driving actions toward targets.
 - ii. **Implement the use of scorecards.** In addition, Management will incorporate the use of scorecards at the project and portfolio levels to continuously track performance against goals, foster planning, and align strategies towards achieving expected results. Management is currently working on improving portfolio supervision (sovereign guaranteed operations and technical cooperation), identifying leading indicators to enhance execution monitoring, inform decision making and contribute to result delivery.

4.23. Latin America and the Caribbean stands at a crossroads in 2021. The IDB Group's clients will face significant challenges to craft adequate policies that set the economies on a new sustainable growth path, create fiscal space to meet their citizens' needs, and fight poverty. Absent proactive policymaking, the region could face increased public demands on governments that would translate into greater social instability than that experienced in 2019. If debt sustainability concerns are not properly addressed, macroeconomic crises and default may ensue. More devastating effects of climate change might render countries less able to respond or recover. Increasing reliance on technology, if not adequately managed, might raise privacy and security concerns and mistrust in institutions. As certain groups will find it more difficult to enter the labor market and adjust to new skill demands, technology adoption may generate unemployment and higher poverty and inequality. This can be a formula for another "lost decade" for the region.

4.24. The IDB Group, as the preeminent regional development institution, has an important role to play in Latin America and the Caribbean and must take decisive action to increase its ability to respond to its clients and help them mitigate these risks. Maintaining the status quo could undermine the IDB Group's role in the region and delay the much-needed post-COVID-19 recovery. The IDB Group can help finance growth-enhancing investments to improve economic prospects, address citizens' needs, and improve social and economic stability.

4.25. The IDB Group will work with governments, civil society, and the private sector, as well as with the development community, to contribute to a more prosperous, inclusive, and sustainable region at a time when close coordination among all stakeholders and development actors is most needed.

4.26. By 2025, a financially resilient and strengthened IDB Group will have achieved the following results:

³⁹ For more detail see Annex VI.

- i. Offered timely and effective support to recover from the COVID-19 crisis and restored higher levels of growth.
- ii. Helped governments secure the COVID-19 vaccine and its distribution and supply chain.
- iii. Delivered sustained higher levels of lending to the region, assessing, and adapting to evolving needs with existing and new instruments.
- iv. Leveraged IDB Invest and IDB Lab private mobilization for the region.
- v. Facilitated a more strategic use of technical cooperation resources.
- vi. Put in place a recapitalized and energized IDB Lab that contributes to supporting economic progress, inclusion, and innovation in the region.
- vii. Supported the use of green instruments to support stand-alone climate projects, including the creation of a business line.
- viii. Fostered stand-alone gender and diversity projects.
- ix. Promoted the digital economy by enhancing digital governance and institutions, regulatory framework, digital talent, and connectivity (especially in rural areas)
- x. Encouraged the reactivation of the productive sector by taking advantage of nearshoring opportunities, financing sustainable infrastructure, supporting entrepreneurship, and supporting the adoption of new technologies.
- xi. Promoted social progress through job creation, sounder safety nets, better service delivery, skill development, and the empowerment of women.
- xii. Supported good governance and institutional strengthening, fostering fiscal sustainability, transparency and integrity, the rule of law, citizen security and justice, digital government, and responsive public management, and therefore a favorable climate for investment, citizen trust, and government effectiveness and efficiency.
- xiii. Enabled efficient and transparent delivery of the IDB Group's priorities and development results through enhanced resource allocation, simplified operational processes, improved monitoring, investment in technology upgrades, strengthening of the skills of the IDB Group's human capital, and a modern management and organizational structure.

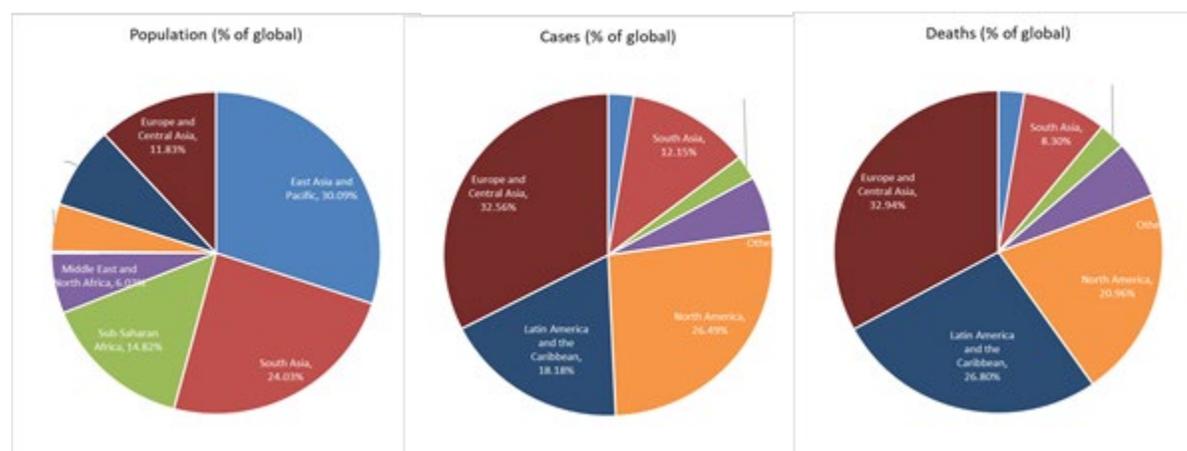
Annex I. Macroeconomic Context

On top of a low growth trajectory for Latin America and the Caribbean -typified by an increase in GDP of 0.1 percent in 2019- the region was faced with a Triple Sudden Stop (TSS) in 2020, caused by the Covid-19 pandemic: it faced a sharp decline in human mobility due to confinements and travel restrictions, a sharp fall in trade (both in volumes and prices), and a collapse in financial flows (both portfolio investments and remittances).⁴⁰

The unprecedented external shock and the consequent reaction through the TSS led to a collapse in output in the second quarter of 2020, followed by an incipient recovery in the second semester of the year that was not sufficient to overturn the significant initial fall, leading to an unprecedented drop in annual regional GDP of 7.4 percent by end-2020.

The inability of the region to conduct proper test and tracing methods, coupled with structural deficiencies in health systems, and inherent characteristics of its population -such as informality, household composition, and pre-existing conditions- led to a large number of deaths due to Covid-19. As a matter of fact, even though Latin America and the Caribbean accounts for only 8.2 percent of world population, it accounted for 18.2 percent of Covid-19 global cases and 26.8 percent of deaths (Figure 1).

Figure 1. Population, Covid-19 cases, and Covid-19 related death shares

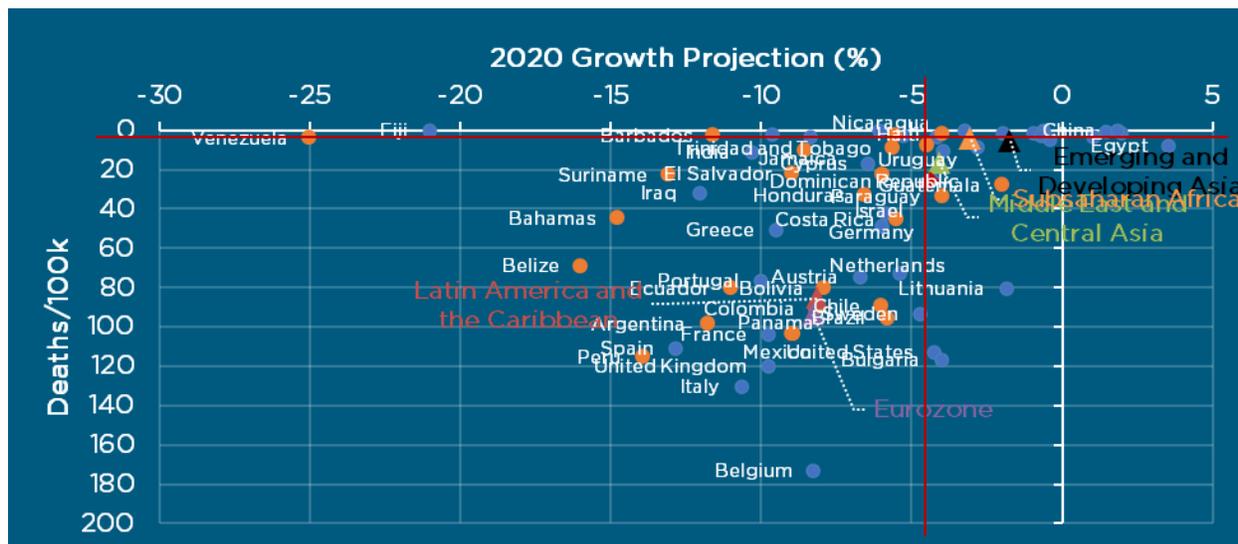


Source: IDB staff calculations based on Our World in Data.

This combination of unprecedented economic contraction and more than proportional deaths puts the region in the worst possible quadrant of outcomes. As indicated by Figure 2, compared to other emerging regions, Latin America and the Caribbean has fared the worst, with both the largest falls in GDP and the largest numbers of deaths per 100,000 inhabitants. This dire starting position for recovery points to significant challenges ahead.

⁴⁰ For more details, see “Latin America’s Triple Sudden Stop,” E. Parrado, Project Syndicate, August 2020; and “Enfrentando la Triple Parada Súbita de América Latina y el Caribe”, A. Izquierdo and E. Parrado, Pensamiento Económico, Nr. 9, September, 2020.

Figure 2. Economic Contraction and Deaths per 100,000 Inhabitants, 2020



Source: WEO October 2020, IMF, and OurWorldinData.

Moreover, given the preexisting conditions in the region, the crisis has affected the poorest families disproportionately. The economic impacts are large and unequal: 45 percent of families in the region report that a household member lost a job, and among households owning small businesses, 59 percent of respondents report that a household member closed their business. Among households with the lowest income prior to the pandemic, 71 percent report that a household member lost their job and 61 percent report that a household member closed their business. Declines in food security and healthiness are among the disproportionate impacts.⁴¹

These challenges are compounded by the effects of the Covid-19 crisis on poverty. Moderate poverty is expected to increase by 3 percentage points, or 19.4 million people, while extreme poverty is expected to increase by 4 percentage points, or 25.9 million people. In other words, the pandemic will push 44 million people into poverty. At the same time, the consolidated middle class will likely decrease by 7.7 percentage points, or almost 52 million people.⁴²

Countries in the region have responded to these challenges with preservation measures for households, jobs and firms of varying intensity, ranging from 1 percent of GDP to 14 percent of GDP, in many cases correlated with fiscal space. These responses, coupled with substantial falls in tax collection have led to large increases in fiscal deficits, which deteriorated from 2.9 percent of GDP in 2019 to 8.3 percent of GDP in 2020. Many of these fiscal measures will not be easy to revert given increases in poverty and unemployment that will linger in the medium term, implying that substantial deficits will stay with the region for a while. This will have a substantial impact on public debt levels, which are expected to increase on average from 58 percent of GDP to 75 percent of GDP by end-2020 and could reach almost 80 percent of GDP by 2022. These unprecedented debt levels will pose the region with the difficult task of redirecting fiscal policy

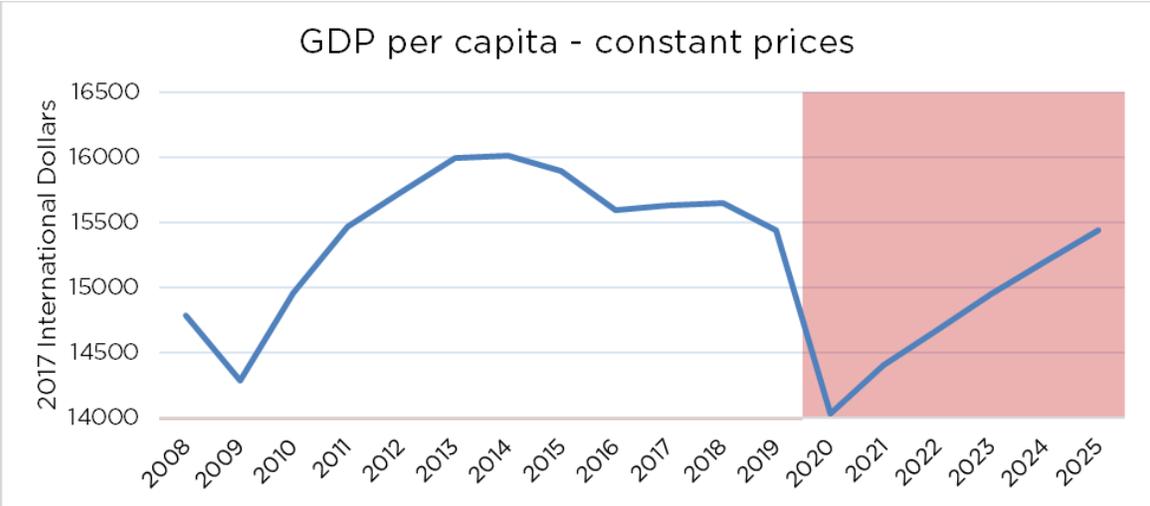
⁴¹ For details see N. Bottan, B. Hoffmann, D. Vera-Cossio, 2020.

⁴² See Acevedo et al. (2020) Extreme Poverty is defined to encompass those living on daily per capita income below US\$3. Moderate Poverty is defined to encompass those living on daily per capita income of between US\$3.01 and US\$5. Consolidated Middle Class is defined to encompass those living on daily per capita income of between US\$12.4 and US\$62.

towards pro-inclusive-growth measures while preserving fiscal sustainability. Currently, six countries in the region have negative outlooks for their sovereign credit ratings, a stark measure of the fiscal challenges ahead. Fiscal deficits are expected to fall to 5.6 percent of GDP by end-2021, and 4.7 percent of GDP by end-2022. However, these forecasts imply that substantial financing will be required in the medium term. So far, several countries have issued sovereign bonds with good financial conditions, however, if not properly handled, governments in the region run the risk of losing access to credit, an instance that could have disastrous consequences for recovery and inclusive growth.

Faced with such a long list of challenges, returning to mediocre growth prior to the Covid-19 crisis is not an option. Current projections indicate that without strong interventions, GDP per capita is likely to recover to pre-crisis levels only by 2025 (Figure 3). The region needs to face a new strategy to successfully exit the pandemic tunnel with more growth and equity. To do this, LAC must implement a new set of policies that not only help preserve jobs, firms, and households, but also incorporate a new social contract that provides greater opportunities, and at the same time reduces inequality,⁴³ to achieve greater inclusive growth once the pandemic is over.⁴⁴ While the region is in the tunnel, the first priority should be to address the pandemic and limit the economic costs of the crisis. This is what the countries in the region are doing to a greater or lesser extent according to their fiscal space and institutional capacity. But limiting losses will not be enough and very few are currently thinking about policies for inclusive growth in the future. Failure to address these types of policies, despite how difficult it might seem to implement them, can be an important omission.

Figure 3. GDP per-capita Projections (constant prices) for Latin America and the Caribbean



Source: IDB staff calculations based on data from October 2020 WEO, IMF.

⁴³ For details about inequality see IDB 2020q.
⁴⁴ This strategy can be seen in Izquierdo et al, 2020.

Annex II. Balance Sheet Optimization: IDB Group

The Governors defined the Bank's risk appetite for its overall operation, as well as specific risk types, enabling synergy between different areas of the IDB Group. This is documented in a comprehensive quarterly Financial Risk Report to the Board of Directors. Starting in 2014, the combined measures described below significantly improved the Bank's capitalization, including an 8-percentage points, or 50 percent relative increase in risk-adjusted capital ratios,⁴⁵ building adequate buffers and supporting the annual lending levels set by the ninth General Capital Increase. The more robust policy framework, strict adherence, and proactive management on the side of the Bank also resulted in the IDB's Enterprise Risk Profile being upgraded to attain a triple-A rating on a stand-alone basis. Finally, efforts to optimize the IDB Group balance sheet have proven efficient in enabling the Bank to increase its lending capacity during the COVID-19 crisis.

Capital Efficiency. In 2014, the IDB Governors approved a Capital Adequacy Mandate aimed at maintaining the IDB's AAA rating with all major agencies, while deploying capital in the most efficient manner. In 2015, the Governors approved further capital regulations that includes buffers, which are explicitly calibrated to sustain lending capacity during a downturn and enable counter-cyclical lending in times of stress. The regulations also dictate rules for capital accumulation. Also, in 2014, IDB Lab implemented a model to optimize its own balance sheet, make more efficient use of its resources, and be in a stronger position to negotiate capital increases with Donor countries. Further, in 2020, the IDB Group optimized the management of Undisbursed Loan Balances through initiatives to cancel unused ULB and repurpose loans during the COVID-19 crisis to accelerate disbursements.

Exposure Exchanges. In 2015, IDB signed a framework for Exposure Exchange Agreements (EEA) and executed two transactions: \$2 bn with the IBRD and \$2.9 bn with the AfDB. In 2020, IDB executed an EEA with the ADB for \$1 bn. These transactions contributed to a significant reduction of around 5-percentage points in concentration of the top-five borrowers and improved risk-based capital ratios. Also, in 2020, IDB contracted a pilot SG portfolio guarantee with the Swedish International Development Agency designed to reduce SG portfolio concentration and improve capital ratios. The IDB Group remains interested in transactions bringing further diversification to its sovereign-guaranteed portfolio.

Financial innovations using Concessional Windows. Effective 2017, the IDB Governors agreed to transfer the assets and liabilities in the Fund for Special Operations (FSO) to the Ordinary Capital (ORC). This initiative strengthened the provision of concessional finance to low-income countries, while enabling to leverage the fund balance in the FSO for balance sheet optimization. It strengthened the ORC capital base by \$5 billion, or about 20% at the time, contributing to meet the targets set by the Governors for capital buffers. The transfer further ensured continued access to concessional financing by the Bank's low-income countries, which would have otherwise been in decline after 2017. In 2020 the IDB Group Governors approved the transfer of residual assets in the Intermediate Financing Facility (IFF) to the IDB Grant Facility and the termination of the IFF. This allowed the Bank to reduce slightly the expected OC income transfer for 2021, reduce administrative expenses, and offer a one-time payment to settle all expected future subsidy payments to eligible IFF eligible countries.

⁴⁵ S&P Global Ratings, "Supranationals Special Edition 2019: Comparative Data For Multilateral Lending Institutions", October 16, 2019.

Sharing risk in non-sovereign operations. IDB merged out its private sector operations into IDB Invest in 2016, at the same time strengthening both the capital and lending capacity of IDB Invest. The IDB Group has set explicit targets for mobilization of private sector resources, measured in terms of B-loans, trust funds, as well as co-investment raised on behalf of its clients. IDB Invest participated, together with other private-sector focused MDBs, in the joint effort to standardize and report common measures of mobilization and address possible bottlenecks, including pricing signals. An internal rating system and cross-booking of NSG loans enabled optimization of the NSG portfolio across the IDB and IDB Invest balance sheets, opening opportunities for active management and mobilization of resources. The IDB Group continued to pursue collaboration with other MDBs and private sector counterparts to achieve larger scale, enhanced risk diversification and attract potential investors.

Net Income measures. The IDB Group Governors approved an Amendment and Restatement of the Income Management Model (IMM) in 2015, tying the capital regulations and lending capacity to specific actions on the income side. The revised IMM model led in 2015 to income measures enacted on both the revenue and the cost side of the Bank. Starting in 2016, the Governors approved an enhanced procedure for transfers under the IDB Grant Facility, which fully preserves the net benefit to the receiving country, while also optimizing the impact on the balance sheet. For 2021, additional income measures were enacted on both the revenue and the cost side of the Bank to strengthen equity accumulation and provide a signal to rating agencies, particularly in a context of high uncertainty.

Annex III. Resource Mobilization Strategy

As a multilateral development bank serving LAC during its most severe socio-economic crisis in decades, the IDB Group is strategically positioned to both foster a post-pandemic recovery and to advance the longer-term goal of achieving the SDGs. Meeting these objectives will require more than IDB Group financing and knowledge – it also calls on the IDB Group to double down on its resource mobilization strategy and expand efforts to mobilize resources from the private sector and other development financiers. This expanded focus on resource mobilization is critical to achieving the IDB Group’s tier-one and tier-two objectives alike: the mobilization of partner resources will be essential to helping countries spur recovery and achieve sustainable and inclusive economic growth, and it will also be fundamental to strengthen the IDB Group’s financial response capacity and value proposition.

These efforts are necessary because development financing is scarce and must be complemented by the mobilization of third-party financing both to meet the immediate priority of addressing the COVID-19 health crisis and minimizing its social and economic consequences, as well as the long-term priority of supporting the achievement of the SDGs and the execution of IDB Group priorities as established in the Update to the Institutional Strategy 2019 and in line with the Administration priorities outlined in “Vision 2025. Reinvest in the Americas: A Decade of Opportunity.”

Building upon the Update to the Institutional Strategy 2020-2023 (UIS), the “IDB Group’s Mobilization Roadmap 2020-2023,” outlines efforts to increase resource mobilization in all borrowing member countries. The Roadmap will prioritize three pillars for action: enhancing resource mobilization, promoting domestic resource mobilization, and catalyzing private finance. These pillars are intended to build and expand upon existing IDB Group efforts related to resource mobilization, with a particular focus on domestic and private finance as captured in the second and third pillars. It will also prioritize five concrete actions to increase mobilization through IDB Group operations: programming and project origination, engaging partners and providing partnership services, prioritizing innovative instruments, creating internal incentives, and tracking results and mobilizations.

Strategic Actions by Pillar

Enhancing Resource Mobilization	Promoting Domestic Resource Mobilization	Catalyzing Private Financing
<ul style="list-style-type: none"> - Mobilize funds for COVID-19 and natural disaster response (example: the Resilient Caribbean Initiative). - Strengthen and expand co-financing platforms and agreements with other MDBs and bilateral agencies through result-based loans, policy-based loans, and by combining grant contributions with co-financing and expanding the scope of eligible countries and sectors. - Boost project preparation facilities that accelerate project financing to further expand public-private partnerships (PPP) and NDCs (example: the Amazon Fund, Climate and Sustainability Facility, etc.). - Formalize new partnerships and revamp initiatives with private sector and philanthropic partners to support the private-sector led recovery and promote the Administration's focus areas outlined in "Vision 2025." - Incorporate resource mobilization efforts into country strategies and programing. 	<ul style="list-style-type: none"> - Engage more domestic actors and financing sources for co-investment with IDB Lab funds and facilities and IDB Invest transactions and funds. - Strengthen local capital markets by leveraging donors' grant resources to enhance local participation in generating development impact (via SME financing, infrastructure investment, etc.). - Mobilize grants to support the development of guarantee operations, SDG bond issuances, and other innovative domestic mobilization products. - Use IndexAmericas to mainstream sustainable investing in additional countries, alongside stock exchanges and regulatory authorities. - Pilot an SDG rating tool to support national development banks (NDBs) in the issuance of SDG bonds and alignment of domestic resources. 	<ul style="list-style-type: none"> - Increase mobilization in smaller, non-investment grade markets through innovative financing instruments like de-risking and blended finance. - Engage investors in investment grade countries and countries large enough to generate scale. - Enhance project preparation facilities that accelerate project financing by creating a pipeline of bankable projects. - Launch SDG Americas platform to promote private investment for sustainable investment. - Mobilize technical assistance grants and concessional financing to structure and tap capital markets with CatBonds, and other innovative solutions such as Commodity Hedges. - Collaborate with public sector partners to leverage private capital and promote a private sector-led recovery in the LAC region.

Under this Strategy, each pillar complements each other and features a focus on:

- Developing innovative financing instruments that leverage IDB capital, such as guarantees, securitization, loans to enhance countries' credit ratings, and blended finance, among others.
- Identifying private co-financing targets via public sector loans and the use of guarantees.
- Coordinating efforts across the IDB Group to increase mobilization targets through the deployment of funds under administration, third party private co-financing, and public co-financing.

Specifically, the first pillar involves engaging traditional and non-traditional partners to channel concessional resources to funds, specific projects, and de-risking mechanisms that can support the second and third pillar. The second pillar focuses on how IDB Group operational instruments, such as guarantees, bonds, and others, must be used to activate domestic mobilization and incentivize local private sector participation. Here, the IDB Group also recognizes the importance of working with local regulators to foster more active local capital markets and of educating local institutional investors on project finance structures to promote more local currency project bonds. Finally, the third pillar focuses on mobilizing private capital through several means, including the use of donor resources through blended finance to absorb risks that constrain private sector

involvement. In addition, mechanisms through the A/B Loan Program, among other efforts, can be used to support private financing.

Together, these pillars are intended to continue expanding resource mobilization from the public and private sectors alike, to strengthen the region's mobilization capacity and facilitate investment and a private sector-led recovery, and to catalyze private financing both to achieve the immediate priority of addressing the pandemic and the medium- and long-term priorities outlined. Moreover, these efforts are critical to achieving the tier-two objectives of strengthening the IDB Group's financial response capacity and value proposition, thereby ensuring the IDB Group's continued relevance and competitive edge in the region.

Main lines of Action

Within the five concrete actions outlined in the IDB Group's resource mobilization strategy, in the near-term special emphasis will be placed on: programming and project origination; developing innovative instruments; and creating internal incentives.

1. Programming and Project Origination

To achieve the aforementioned goals and effectively boost resource mobilization, resource mobilization considerations must be integrated as a key component of country and sector plans. This will create greater awareness about the importance of resource mobilization and will make resource mobilization an essential component of all IDB Group programming. Moreover, it will facilitate coordination with other financial institutions. To this end, the IDB Group will need to build new strategic partnerships and further strengthen coordination with existing traditional and non-traditional partners in borrowing member countries. It is recommended that these efforts involve the identification of financing gaps in the IDB Group's country envelopes as well as priorities for additional financing to facilitate engagement with co-financiers early into the country programming process and to help identify opportunities for engagement with private investors. Together, these steps will enable the IDB Group to accelerate its evolution from an institution focused lending to one that serves as a platform for solutions and prioritizes resource mobilization to meet development financing needs.

2. Developing Innovative Instruments to Mobilize Financing

The development of innovative instruments that leverage IDB Group capital and expand the IDB Group's financing capacity will continue to be a priority. As previously described, the IDB Group has at its disposal a portfolio of instruments that can be used more frequently to enhance mobilization and better serve client needs, while the IDB Group should continue to expand its capacity to devise new innovative mechanisms. These instruments may feature such elements as results-based financing, blended finance, first-loss guarantees, liquidity backstops, and other de-risking tools, and are important vehicles for layering financing, as previously described.

The IDB Group must also develop a new generation of co-financing agreements and partnership modalities. The IDB Group's new procurement policies will facilitate these efforts by enhancing its ability to establish partnership agreements, including mutual reliance agreements with other co-financiers which reduce transaction costs for clients, as well as new procurement modalities for the implementation of PPPs which may contribute to enhanced domestic resource mobilization. To this end, in the past few years the IDB Group has begun negotiating and signing pioneer co-financing agreements with bilateral development agencies to enhance operational

alignment and facilitate resource mobilization. Across the board, catalyzing private finance will be a priority under this line of work.

3. Creating Internal Incentives for Mobilization

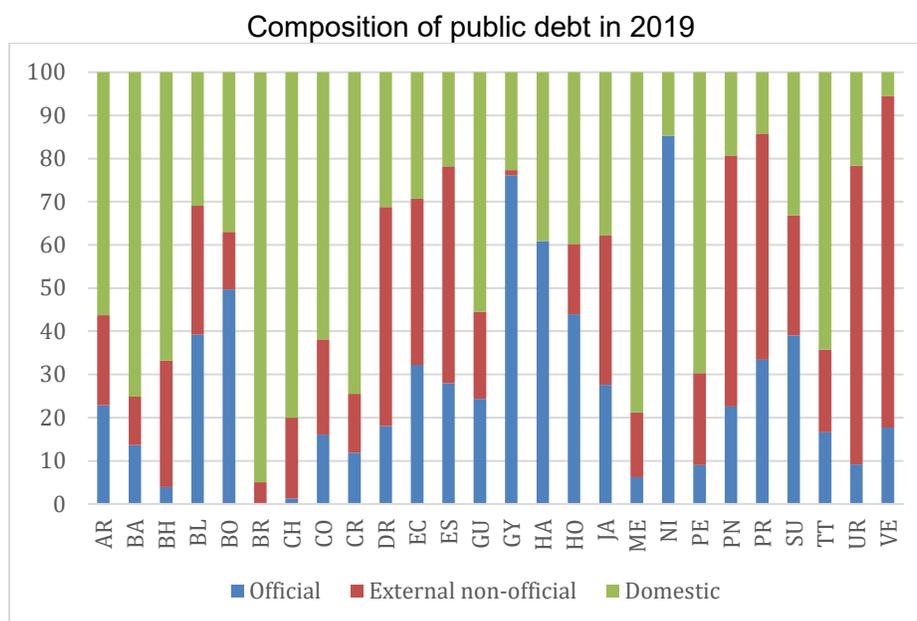
Expanding resource mobilization will require its operationalization and mainstreaming across the IDB Group, which will in turn require enhanced coordination across departments and divisions. The ongoing focus on product development and external outreach must be complemented by efforts to identify and recognize internal champions for mobilization and to make resource mobilization a core aspect of all IDB Group programming and financing efforts. This internal mainstreaming process will be critical to helping the IDB Group solidify its position as a leader in resource mobilization, and thus critical to achieving both tier-one and tier-two objectives.

Incentives are critical to enhancing mobilization. Thus, the IDB Group should reorient internal incentives toward the mobilization of external resources, rather than exclusively prioritizing the deployment of its own financing. Defining concrete resource mobilization objectives, as established in the CRF and “Vision 2025” document and integrating resource mobilization metrics into the work plans of diverse IDB Group employees will be critical to shaping a corporate culture geared toward mobilization and the crowding-in of private investment.

Annex IV. Scenarios: Demand for Financing

Latin America and the Caribbean is facing one of the worst crises in its history, the full magnitude of which is hard to quantify yet given the high degree of uncertainty regarding the duration of the crisis and access to vaccines. Over the next several years, the region's countries, left with little room to maneuver, will have to allocate the limited fiscal resources they have to policies for overcoming the health crisis and containing its social and economic costs.

Against this backdrop, the public sector's external financing needs are expected to top US\$110 billion per year, on average, over the next 10 years (excluding Venezuela).⁴⁶ The external financing needs of Latin America and the Caribbean for the 10-year period running from 2021 to 2030 have risen as a result of the combined effect of the impact of the pandemic, the effects of climate change, and the large gaps in investment. Yet, the countries of Latin America and Caribbean also vary in ways that will inform their financing strategies. For example, some countries have relied primarily on external debt for their financing, whereas others with more developed capital markets, such as Brazil, Chile, and Mexico, have drawn on domestic financing. In addition, there are significant structurally-driven differences in the composition of external debt, and these too will shape the demand for financing in the future, with the countries relying to greater or lesser degrees on multilateral financing.



Source: Vice Presidency for Countries (VPC), the respective Departments, and the LAC Debt Group.

Preliminary estimates put the minimum demand for financing from the IDB at over US\$12.7 billion per year on average in the period 2021-2030. In addition, further resources approaching US\$1 billion per year will be needed during the period to support a reconstruction plan in Venezuela, bringing total demand to US\$13.7 billion per year.

⁴⁶ To calculate external financing needs, total financing needs were estimated and the following assumptions were made: (i) needs would be financed entirely with debt and not with reserves; and (ii) the new debt would preserve the same structure of domestic and external financing as in the 2019 debt stock.

However, these estimates are merely the floor inasmuch as they assume that the IDB's participation in new external debt will replicate the pattern established in 2015-2019, an optimistic scenario given the sizable fiscal deterioration that has been observed. A more likely scenario, one that will continue to be refined, would anticipate an increase in the IDB's participation, considering that access to financial markets will be more restricted and/or more expensive for many countries in the years ahead. For example, if the countries were to increase the share of IDB financing in their new external debt by five percentage points, demand would rise to US\$19.2 billion.

Additional risks must also be considered, such as: (i) new crises during the period, given that the IDB has historically increased its disbursements by 28% per year over trend; (ii) the possibility that many countries may not succeed in making the adjustments needed over the next several years and may have to resort to additional borrowing; and (iii) the need to close large gaps in infrastructure investment and achieve the climate change targets, all issues that will be analyzed in the more detailed estimates. On this last item alone, IDB estimates indicate that the public investment gap/deficit in Latin America and the Caribbean stood at 3.1% of GDP in 2015.

These orders of magnitude need only be contrasted with the annual approval and disbursement averages for 2015-2019, which were US\$10.946 billion and US\$9.151 billion, respectively, to get an idea of the Bank's limited capacity to respond to the needs and challenges forecast for the decade ahead.

Annex V. Tier 2: Strengthening the IDB Group Financial Response Capacity and Value Proposition

I. Scaling up financial capacity	
Balance sheet optimization	<ul style="list-style-type: none"> • Explore portfolio, first-loss guarantees from highly rated shareholders, and • Pursue portfolio exchanges across multilateral development banks.
Efficient and increased resource mobilization	<ul style="list-style-type: none"> • Develop innovative instruments to leverage its capital. • Seek private financing targets via public sector loans and the use of guarantees. • Coordinate efforts across the Group to increase mobilization targets. • Enhancing programming and project origination activities and creating internal incentives.
Coordination with national and international financial institutions and partners	<ul style="list-style-type: none"> • Participate in Country Platforms to achieve effective coordination across development partners and to help countries prioritize their key development issues.
Capital adequacy limits	<ul style="list-style-type: none"> • Review the debt-to-equity limit policy to assess its appropriate level. to right-size capital needs.
Capital increase-10	<p>Increase resources to</p> <ul style="list-style-type: none"> • improve financial sustainability. • assure a better response to countries' needs / demands. • serve as a buffer for unforeseen crises. • support Venezuela's reconstruction plan.
II. Enhancing value proposition	
Updating the existing financial offering	<p>Propose measures to offer:</p> <ul style="list-style-type: none"> • a competitive and comprehensive set of products. • greater flexibility for crisis response. • expanded liquidity supply.
Efficiency	<p>Seek quality over quantity in the operations and better use of resources through:</p> <ul style="list-style-type: none"> • strategic use of technical cooperation. • enhanced project design. • sound project monitoring and management. • digital transformation. • improved institutional governance.
Utilize knowledge and expertise	<ul style="list-style-type: none"> • Develop a Group-wide knowledge agenda. • Reinforce the linkages between knowledge, technical assistance, and the lending program. • Enhance the use of evaluation results.
Pursue public-private synergies	<ul style="list-style-type: none"> • Strengthen coordination to deliver comprehensive country strategies. • Create incentives to foster operational synergies.
Monitor and measure results	<ul style="list-style-type: none"> • Foster the use of existing result measurement tools. • Implement the use of scorecards.

Annex VI. Measuring the Vision 2025

The Corporate Results Framework 2020-2023 (CRF)⁴⁷ will help monitor progress in the areas of Vision 2025 (i.e. regional integration, innovation, gender, climate change, efficiency). To complement it, with the objective of strengthening the measurement of results within the IDB Group, the following options will be explored:

- Strengthen existing monitoring and reporting tools, results frameworks, and IDB Group action plans that already establish targets and monitoring mechanisms for many of the priorities of the Vision 2025 (e.g., climate change, gender equality). Likewise, to better capture areas such as support for digital technology and support for MSMEs, new metrics could be pilot-tested. This process will involve: (i) identifying concepts to be measured and establishing dedicated working groups; (ii) developing specific indicators and definitions, in such a way to guarantee consistency across the entire IDB Group, drawing on best practices used by peer institutions; (iii) establishing business processes and roles to ensure accuracy and systematic capture of the information within the Group's official data systems; (iv) establishing baselines for each entity of the Group; targets will be developed for those indicators for which the IDB Group has direct influence; and (v) refining definitions, and business processes over time to better reflect the intention of the metric. Once this process is complete, a formal proposal will be presented to the Boards for integration into the Group's Corporate Results Framework, where appropriate.
- Better integrate monitoring mechanisms and displays across the IDB Group, through a one stop shop for progress data on key priorities. Specifically, an integrated Vision 2025 dashboard could be developed to report on indicator progress; quantitative information on the dashboard could be complemented with links to recent reports that provide greater detail on specific topics (e.g., IDB's Gender Action Plan for Operations).
- Enhance business processes to drive toward targets, including improved integration with budget process and enhanced monitoring instances. The Group can enhance existing planning and budgeting processes to make them more results-based and increase ties to the most critical targets. In addition, institutionalizing regular monitoring instances to check progress, identify lagging indicators, and define remedial actions will help pursue targets.

⁴⁷ For complete details on the CRF 2020-2023 indicators and targets, visit www.iadb.org/crf.

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