EXECUTIVE SECRETARIAT

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Executive Secretary

9/14/83

Date

3637 (10-81)

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

September 13, 1983

MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
DIRECTOR OF CENTRAL INTELLIGENCE
UNITED STATES TRADE REPRESENTATIVE
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
ADMINISTRATOR, AGENCY FOR INTERNATIONAL DEVELOPMENT

SUBJECT Senior Interdepartmental Group on International Economic Policy (SIG-IEP)

A meeting of the SIG-IEP is scheduled for Friday, September 16, at 11:00 a.m., in the Roosevelt Room. The agenda is as follows:

1. International Debt Update; and
2. Proposed Inter-American Investment Corporation.

A paper on agenda item 2 is attached. Attendance will be principal, plus one.

DTR
Donald T. Regan

Attachment

B223B

U.S. Participation in

Proposed Inter-American Investment Corporation

Treasury is seeking SIG-IEP support for U.S. participation in a proposed $200 million Inter-American Investment Corporation (IIC). The IIC would be an affiliate of the Inter-American Development Bank (IDB); it would be located in IDB headquarters in Washington and would rely on the IDB for administrative and logistical support.

The U.S. share of the proposed corporation would be up to 35 percent or $70 million. U.S. subscriptions to the Corporation would be paid in four equal installments beginning in FY 1985. Funding for the IIC has been included in the planning figures for the FY 1985-88 budgets.

The IIC fills a need created by the economic evolution of Latin America and the Caribbean. As the IDB's borrowing member countries have developed, it has become evident that a serious economic constraint has been a lack of private sector access to capital markets particularly for equity investments. The IDB conservatively estimates a gap of $1.2 billion annually in the long-term financing of small and medium scale enterprises (SMSEs) of the region. The IDB also estimates that the above figure includes approximately $410 million annually in equity requirements. Clearly the proposed IIC will not fill all the financial requirements of the regions SMSEs. By creating the IIC, however, we will be expanding the scope of IDB activities more completely in order to address the development needs of Latin America and the Caribbean, particularly its poorest members.

Description

The IIC is designed to support private sector activities in Latin America through equity and loan investments. The primary focus of the IIC would be SMSEs. Enterprises with partial government involvement would be eligible for financing if the proposed investments could be demonstrated to strengthen private sector activities. Because of the focus of the IIC, we expect that the primary beneficiaries will be the poorest countries of the region, principally in Central American and the Caribbean.

The IIC will be a multilateral organization whose membership, at the present time, will include almost all of the IDB's borrowing member countries, the United States and Italy. On the basis of communications with nonregional countries, we are confident that more countries will seek to join the IIC soon (particularly Japan, Germany, France and Spain). All subscriptions to the IIC will be made in convertible currencies thus significantly leveraging the U.S. subscription.

Overview

The most recent discussions surrounding the creation of a private sector oriented affiliate of the IDB began over two years ago at the initiative of the Venezuelan Government. Venezuela had become interested in creating a new organization because of their disappointment with the performance of their own IDB administered Venezuelan Trust Fund (VTF). Though the VTF was empowered to make equity investments, it became clear that IDB expertise and administrative procedures did not lend themselves to the task of making equity or loan investments to the private sector. In order to overcome this problem, the Venezuelans broached the idea of creating an independent organization aimed solely at promoting private sector development in the region.

The United States agreed to work with the Venezuelans on their initiative because of our long term view that the creation of such an affiliate would reflect the institutional evolution of the IDB and help meet the financial needs of the Bank's borrowing members by directly assisting a critical part of their economies - the private sector. An analysis of the IDB's financial requirements revealed early on that the economic development in many parts of the region had lessened the need for continued large inflows of concessional resources. What was needed to address the economic requirements of the 1980s and beyond was a program that would (1) concentrate the Bank's resources on the poorer members of the Bank, (2) expand access to the world's capital markets for all developing member countries and (3) create a mechanism that would stimulate private sector activities particularly in the poorest countries. The first two objectives were achieved with the completion of the IDB's Sixth Replenishment negotiations. The last objective is to be realized through the creation of the IIC.

The creation of the IIC will add a new, important, and complementary dimension to our goal of providing effective economic assistance to the poorest countries in the region particularly Central America and the Caribbean.

Structure of IIC - U.S. Objectives

Our overriding goal in designing the structure of the IIC was to create an efficient and professionally run organization in which there would be sufficient internal checks and balances to ensure that decision making would be based solely on the quality of the proposed operations. These goals had to be meshed with a Latin American desire to retain nominal control of the institution, i.e., they wished to be the majority shareholders. As the negotiations progressed, it became clear that the Latins would relinquish considerable operational authority over the organization if they could retain symbolic control.

The tentative agreement that was reached at the July 14 and 15 meetings of interested parties reflects the meshing of these objectives.

Tentative Agreement

The tentative agreement contains the following elements:

Size: $200 million, to be paid in over 4 years by participating countries in convertible currencies.

Distribution of Capital Shares: Latin America and the Caribbean would receive 55 percent of the capital shares, the United States and other industrialized countries would receive 45 percent, of which the U.S. share would be up to 35 percent. This compares to the current shares in the IDB of almost 54 percent for Latin America and the Caribbean and 46 percent for the industrialized countries. The U.S. owns 34.5 percent of IDB capital and 41% percent of the IDB's Fund for Special Operations. Voting power on the Board of Executive Directors will be equal to capital shares.

Executive Committee: Although Latin America and the Caribbean will hold nominal control of the IIC, actual approval or rejection of individual equity and loan operations will be governed by a four-person Executive Committee selected from the Board of Executive Directors. The Executive Committee would review all investments prior to consideration by the Board of Executive Directors. This committee would be comprised of two Latins, one American, and one nonregional, each member would have a 25 percent vote. Approval of an investment operation requires a favorable vote by three out of four of the Executive Committee members. If approval is granted, the proposal goes to the full Board of Directors where, unless a Director specifically asks for a Board discussion within a specified time period, it is considered approved. In instances where at least three out of four Executive Committee members vote against a proposal, the proposal is considered terminated. An individual Board member can, however, request a review and explanation by Management and the Board can make recommendations regarding the operation. The Board cannot, however, overrule a negative decision by the Executive Committee.

In cases of a tie vote, the proposal will be sent back to Management for reformulation if considered desirable or possible. If Management believes that the concerns raised by the Executive Committee are valid and the proposal cannot be reformulated, they can terminate the proposal at that stage. If they choose to bring it forward a second time, and a tie again results, the Chairman of the Board of Directors of IIC, who will be the President of the IDB, will cast the deciding vote.

Board of Executive Directors: The Board of Executive Directors will be comprised of thirteen directors, nine from Latin America and the Caribbean, one from the United States, and three from other countries. This formulation is similar to that of the IDB except that the IIC has one additional director from Latin America.

The additional seat was required to give more complete Latin representation on the IIC Board. In order to keep administrative expenses to a minimum, it has been decided that members of the IDB Board of Directors will act, wherever possible, as members of the IIC Board of Directors.

General Manager: It is our view that the success or failure of the IIC will be determined in large measure by the quality of the person chosen to be General Manager. The General Manager, in practice, will be responsible for the daily operations of the IIC including the hiring and firing of IIC personnel. The General Manager also has ultimate responsibility for selection, preparation, and submission of investment proposals to the Executive Committee. In order to ensure that the individual selected has the widest possible support, the charter will require that members comprising 80 percent of the total voting power concur in the selection. This percentage will also allow a U.S. veto in the selection process.

Issues Still to be Resolved

Though significant progress was reached in the July 14-15 meeting, two issues remain. While they are important, we do not believe they are sufficiently serious as to put the creation of the IIC at risk. These are:

a. Distribution of Capital Shares Among Member Countries: A consensus was reached that the Latin Americans and the Caribbean would receive approximately 55 percent of the IIC while the U.S. and other interested parties would receive 45 percent. Specific country shares have not been finalized though it would appear that the U.S. will initially take approximately 30 percent and Italy 5 percent leaving approximately 10 percent open for other industrialized countries interested in joining the IIC. We would consider lowering our share a few percentage points to permit the greatest number of nonregional countries to join. The Latin American situation is somewhat more contentious. The Venezuelans, as co-sponsors of the IIC, would like to be equal to the largest Latin member. However, Brazil and Argentina, currently the co-largest Latin members in the IDB, insist that they retain their IDB ranking in the IIC. While a difficult issue for the Latins, we believe they will be able to arrive at a solution before the next meeting of interested parties.

b. Majority needed for Special Votes: Voting arrangements for membership, capital expansion, and transfer of resources usually require special majorities (e.g., such language usually requires the approval of members accounting for three-fourths of total votes and two-thirds of the Governors). Some percentages have not yet been agreed upon though we do not expect that this will be a serious issue.

Next Step

The next meeting of interested parties is now scheduled for November 3rd. Working Groups comprised of IDB Executive Directors are expected to have ironed out most of the remaining issues prior to the meeting. If the SIG-IEP concurs, the U.S. would formally indicate its intention to join the IIC and the level of our participation at the time of the next meeting. Formal U.S. participation in the IIC will be subject to Congressional authorization and appropriations.

SEP. 13 1983