



Corporación Andina de Fomento

Bridging Latin America
Regionally and Internationally



A Special Advertising Supplement Presented in conjunction with
Corporación Andina de Fomento

Image: View of the recently inaugurated 3,156-meter-long bridge over the Orinoco River, linking Venezuela with Brazil. Photo by Juan Barreto / AFP / Getty Images

CAF: Committed to Sustainable Development and Regional Integration

CORPORACIÓN ANDINA DE FOMENTO (CAF) is a multilateral financial institution that supports the sustainable development of its shareholder countries and the integration efforts within the region. Its shareholders are: Bolivia, Colombia, Ecuador, Peru, Venezuela, Argentina, Brazil, Chile, Costa Rica, Spain, Jamaica, Mexico, Panama, Paraguay, Dominican Republic, Trinidad & Tobago, Uruguay and 16 private banks of the region.

CAF serves the public and private sectors, providing multiple financial services to a broad customer base comprised of its shareholder countries, and corporations and financial institutions within those countries. Social and environmental variables are incorporated into management policies, including ecoefficiency and sustainability criteria. As a financial intermediary, CAF attracts resources from industrialized countries to Latin America, serving as a bridge between international capital markets and the region. CAF has become the largest provider of multilateral financing to the Andean region.

FINANCIAL HIGHLIGHTS

	2001	2002	2003	2004	2005	2006*
Total assets	6,804	7,584	8,818	9,586	9,540	9,708
Liquid assets	1,219	1,399	1,683	1,727	1,788	1,811
Loan/investment portfolio	5,575	6,180	6,712	7,216	7,462	7,522
Shareholders's equity	1,825	2,054	2,380	2,793	3,237	3,622
Net profits	113	127	136	208	283	268

Audited figures, as of September 30 of the year noted

*Unaudited figures as of September 30, 2006

Products and Services

- Short, medium and long-term loans.
- Non-recourse or limited recourse lending.
- Cofinancing with other multilateral and international institutions, including A/B loans.
- Advisory and investment banking services.
- Partial credit guarantees to enhance credit rating of loans and capital market transactions.
- Treasury management.
- Technical cooperation.

Funding

In 1993, CAF was the first Latin American issuer to receive three investment grade ratings simultaneously from Standard & Poor's, Moody's Investor Services, and Fitch. Since then, CAF has received increasingly superior ratings. In 2005, the Japan Credit Rating

INVESTMENT GRADE RATINGS

	Long Term	Short Term
Standard & Poor's	A	A-1
Moody's	A1	P-1
Fitch	A+	F1
Japan Credit Rating Agency	A	A-

CAF's funding strategy allows it to raise financial resources efficiently and competitively in the international capital markets. It is based on the diversification of sources and the mitigation of interest rate and currency risks. It also aims to match the average maturities of assets and liabilities.

Agency assigned a AA- rating on CAF's foreign currency long-term senior debt. This has facilitated CAF's active participation in the U.S., European, and Japanese bond markets. Also, CAF maintains a constant presence in short-term markets through its U.S. Commercial Paper Program, Euro Commercial Paper Program, and Short-Term Note Program in Spain.

Strategic Programs

- South America's Infrastructure Integration Initiative: improves competitiveness through a hemispheric network of rails, waterways, roads, telecommunications and energy systems.
- Andean Competitiveness Program: enhances regional economic performance through the promotion of knowledge and skill-based production structures.
- Latin American Carbon Program: assists the participation of CAF's shareholders in the emerging carbon emissions market.
- Program for Democracy and Governance: supports institutional strengthening efforts of national and local governments.
- Culture and Social Responsibility: strengthens social capital through the enhancement of basic capabilities, including culture, for people's empowerment.
- Biodiversity Program: promotes resource and ecosystem management in order to develop sustainable business opportunities.
- Program for the Support of Small and Medium Size Enterprises: intended to improve SMEs' management, competitiveness, marketing, technology know-how and capacity.
- Kemmerer Inter-Institutional Cooperation: coordinates and strengthens regulatory and supervisory systems for banking, securities, pensions, and insurance in the region. •



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This supplement was produced by Foreign Policy's business department and did not involve the editorial staff of Foreign Policy.

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A Conversation with Enrique Garcia, CEO and President of the Corporación Andina de Fomento

In recent years, CAF has continued to consolidate its strategy of expanding its shareholder base, having recently included shareholders like Argentina, Brazil, Chile, Dominican Republic, Mexico, Panama, Paraguay and Spain, among other nation states. Has this larger and more diverse shareholder base changed CAF's strategy in any way?

CAF's larger and more diverse shareholder base has allowed CAF to expand its operating base beyond the Andean region and become a key player in the economic development and integration of Latin America. Increasing CAF's shareholder base has been a response to the changing economic environment of Latin America with CAF redefining its mission to that of promoting sustainable development and regional integration.

In addition, the incorporation of an ample base of countries contributes to strengthening the financial situation of CAF. Moreover, a larger number of countries in the region allow CAF to promote joint development projects, in areas such as infrastructure, energy and communications, promoting physical and economic integration within the region.

CAF continues to be admired by credit rating agencies and capital markets alike. What explains that a company has a better risk assessment and can access capital in the international markets at lower costs than its shareholders?

CAF has become the best-rated frequent-issuer in Latin America thanks to its consistent financial strength, the support of its shareholders, careful credit management policies, and management independence. Its preferred creditor status, teamed with CAF borrowers' strong track record in meeting their obligations, has allowed CAF to issue bonds in international capital markets under increasingly competitive conditions.

As President of CAF, you have a privileged position on which to gauge the political climate of the region. What can you tell us about politics in Latin America at this time and how do you see its evolving? How should the world interpret the results of the many elections that took place throughout Latin America last year?

Although there have been important political changes through the region, governments today are more pragmatic in terms of economic management, and understand the importance of improving living conditions for Latin Americans, one of the main challenges faced by the region. Also, in general, there is a growing consensus that macroeconomic stability and increasing trade within the



Enrique Garcia
CEO and President
Corporación Andina de Fomento

region are key for development.

The same is true for the business sector, where you also have a unique window from where to assess the situation of private companies in the region. What major changes are going on in the Latin American private sector?

Private sector activity in Latin America continues to be hampered by the presence of structural problems such as distorted labor markets and inefficient state bureaucracies, which adversely affect the business environment and limit GDP growth. Productivity, usually the result of innovative activity by the private sector,

has been lagging in Latin America, and the region's competitive position in the world has been worsening.

Nonetheless, several of the countries in the region have made important reforms improving the business climate, with positive effects on the operations of private companies, both domestic and international. CAF continues to provide strong support to the private sector, not only through direct credits, but also with a variety of products, services and financial instruments aimed at the region's entrepreneurs. The CAF Competitiveness Program (PAC) promotes strategies to strengthen competitiveness in the region, with emphasis on issues such as international trade, governance, environmental sustainability, science and technology.

CAF has made infrastructure one of its top priorities. How much do you estimate are the investment needs for infrastructure in the region and what is CAF's strategy towards Latin America? Infrastructure is a key element for economic development in the global economy, in particular given the geographical barriers present within Latin America. CAF currently dedicates approximately 70% of its portfolio to infrastructure, and this percentage has been growing on a yearly basis. With the launching of the Initiative for Integration of South American Infrastructure (IIRSA) in 2000, CAF's involvement has focused on the modernization and integration of the region's infrastructure and logistics in the transport, energy and telecommunications sectors. Other noteworthy initiatives are CAF's current efforts to promote sustainable social infrastructure development, with emphasis on drinking water, basic sanitation facilities, rural development, health and education.

Remittances from Latin Americans living abroad are one of the main sources of foreign financial flows to the region. What is CAF doing in this area?

Most remittances to the region continue to be chan-

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nelled through non-bank money transmitters, often implying large transaction costs and significant risk. CAF participates in the search for more efficient ways of transferring these important financial flows to the region. For example, CAF provides a special credit line through Banco Solidario in Ecuador for remittances from Ecuadorians working abroad (mainly in Spain), promoting a productive use of their remittances as part of a strategy to include lower income individuals in banking services.

What is happening with trade agreements and trade? Is intraregional trade growing?

Latin American exports have been performing well, with intraregional trade growing at a faster pace than trade with the rest of the world. The region continues to actively pursue both extraregional and intraregional trade agreements as part of a combined strategy to increase its presence in global markets, participating in multiple spheres of international trade negotiations. CAF has supported its shareholder countries in this strategy, for example by providing technical support to the Andean countries in their negotiations of free trade agreements with the United States.

CAF has long had a very active and innovative approach in the funding of social programs. What are some recent activities in this area? What are your main lessons from this experience?

CAF, in its ongoing effort to support social investment in its member countries, has focused on innovation and the continuous search for new instruments. One example is the Spain-Ecuador Debt Swap Fund, one of the first cases of a debt swap where condoned resources are invested in the beneficiary country. CAF administers and manages the US\$50 million fund, proposes projects and provides technical assistance to the Committee that rules the Fund's policies. 60% of the Fund's resources are dedicated to Clean Development Mechanism projects, and the remaining 40% to education projects.

Another example is the MERCOSUR Education Fund (FEM MERCOSUR), which finances programs and projects aimed at promoting regional integration through education. CAF was selected among various multilateral agencies to administer and manage this fund, the first of its kind financed with regional financial resources. •

The Construction of Sustainable Infrastructure Networks for South American Integration

CAF, in its ongoing effort to support social investment in its member countries, has focused on innovation and the continuous search for new instruments.

The construction of infrastructure is the primary intervention of human beings on a territory, to access it and unleash its development potential. It usually begins with the provision of basic services for the survival of settlements — water and shelter — and it rapidly extends to the construction of access roads into the urban periphery and to the development of more advanced technologies for energy generation and long distance communication. Thus, the provision of infrastructure in a territory is intrinsically linked to the level of development, and it becomes a significant determinant of the society's developmental possibilities.

There is a direct relationship between a territory's infrastructure requirements, its geographical characteristics and its socioeconomic organization. Territorial design is determined by its stock of natural resources (including coasts, rivers, mountains, minerals, soils, etc.) and the current and projected location of social and economic activities. The interrelationship among all of these elements is established by what can be called "connectivity networks". The level of development of the connectivity networks of a territory is measured in terms of the endowment and quality of the existing infrastructure. The endowment refers to the quantity and diversity of infrastructure, especially transport (roads, waterways, railroads, ports, airports, pipelines, etc.), en-

ergy (power plants, transmission and distribution networks), and telecom (radio and TV stations, fixed and mobile telephone and internet services coverage). Quality refers to the operational capabilities of the infrastructure, as well as its maintenance conditions.

Clearly, the endowment of infrastructure is not a permanent condition; it needs to be maintained, expanded and adapted to the nature of the production processes and the exchange mechanisms of society. Otherwise, functionality and competitiveness will progressively be lost. By the same token, during the planning process to expand an economic boundary or to promote a particular economic activity, infrastructure restrictions must be taken into account as to avoid possible missing links or bottlenecks that may result in efficiency losses.

At present, South America exhibits important imbalances in its connectivity networks, and a significant portion of what it has is not well suited for greater integration with neighboring countries and with the rest of the world. Some areas are relatively well provided to attend the needs of domestic markets and capital cities, while others urgently need basic access and services. Together with steep reductions to trade barriers, and advances in institutions and governance mechanisms, the region needs to develop infrastructure to integrate neighboring countries through transportation, energy

and telecommunication networks, to gain economies of scale that will enhance the viability of job-generating activities and allow it to develop its competitive and comparative advantages to insert itself successfully in global markets. If infrastructure needs are not addressed (among other important issues), present trends of de-velopment will continue.

Despite over a decade of pursuing various types of reforms and possessing rich natural resources, South America has not grown enough to overcome unemployment, low incomes, and social exclusion for most of its population. Sixty years ago, South American exports accounted for close to 12% of total world exports. Since the mid seventies, they have stagnated around 6% while other regions' exports have exploded. Southeast Asia, for example, has seen its share of world exports triple to over 9% in the same period. China alone has multiplied its share more than four times to over 6%. Intraregional trade is also considerably low relative to other regional blocks. Intraregional trade is very important, since it generally has more value added compared to exports to global markets. While Asia trades within the region 68% of total exports, the European Union 60% and NAFTA 55%, in South America, however, MERCOSUR trades only 25% within the bloc and the Andean countries a meager 10%.

This relatively low level of value added exports explains in part the growth gap with other regions. The lack of trade explains the lack of labor markets dynamism, producing greater inequality in societies. In terms of poverty, most of the countries in the region have seen the populations of their poor grow in recent years. The exceptions are precisely the most active traders, led by Chile and Mexico, with Colombia and Peru somewhat behind.

The way out of this stagnation is through the increase in quantity and quality of domestic production and trade, both among countries in the region and with the rest of the world. For that, the region needs to reduce the cost of taking production to markets, which can only be done through the improvement of its connectivity networks. Investing in infrastructure and related services is not only crucial to address the fundamental problems of the region, but it can also provide valuable short-term relief for the unemployment and household income difficulties faced by the population.

However, infrastructure development is a capital-intensive task, and the region lacks a strong financial system to support it. In most countries, the fiscal deficit and debt service represent significant portions of GDP, hovering around 12% in the case of the bigger economies. Thus, infrastructure provision by the public sector is severely constrained by fiscal budgets. This problem is compounded by the low levels of domestic savings, which added up to only 18% of GDP for Latin America on the aggregate, as compared to many multiples of GDP for developed countries. As a result, investment in infrastructure has represented only about 2.4% of GDP and, since the gap in infrastructure is also widened by poor maintenance, investment needs to increase exponentially. According to a recent World Bank study, the gap in infrastructure adds up to 1.5% of the GDP of



Latin American countries, or the astonishing amount of US\$ 23 billion per year.

South America, a fragmented territory

Although South America may give the impression of being one big island between two oceans, it presents enormous geographical barriers for internal development and integration. The Andean Mountain Range, the Amazon rainforest, fragile ecosystems such as the Chaco and Pantanal, and mighty rivers such as the Amazonas, Orinoco, Madeira or La Plata, generate a set of relatively discontinuous enclaves, or "islands", where human activity is concentrated, mostly disconnected from one another.

The relative disconnection between these "islands" has restrained their development, resulting in hinterlands with low population densities, basic primary sector economies, and considerably high costs of doing business. South America's infrastructure integration challenge is to concentrate efforts to build the most efficient "bridges" (in economic, social and environmental terms) to link these five islands and integrate the continent into one well-functioning economy of global scale.

The IIRSA Initiative

The Initiative for the Integration of South America's Regional Infrastructure (IIRSA for its acronym in Spanish) is, precisely, a big push from the highest political levels to advance the physical integration efforts and overcome these limitations. Started in 2000, it has become the main regional forum to advance the process to physically articulate the twelve countries of the region. CAF has strongly and consistently supported the Initiative, together with the IDB and Fonplata. These agencies provide operational coordination as well as financial and technical support to IIRSA activities and project proposals.

The IIRSA governments agreed to focus the analysis on multinational territories called Integration and Development Hubs (IDHs). They are the macro regions

A gas compression plant of the Spanish company REPSOL on the Rio Grande, in the southern region of Santa Cruz, where Bolivia has its main pipelines that export gas to Brazil and Argentina.

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of South America where intraregional and global development dynamics are thought to be most capable of generating significant investment, employment and trade opportunities. The central premise of the Initiative is that the “bridges” linking the “islands” of South America can be established through the gradual consolidation of the IDHs, and thus, they represent a geographical reference for the design and implementation of sustainable development strategies.

The IDHs were defined as a result of two complementary processes: (i) a territorial analysis based on technical criteria and (ii) a social and political validation through field work. The main technical criteria used were the following:

- Geographic coverage of countries and regions, taking into account the most important demographic, socioeconomic and cultural factors;
- Existing intraregional trade flows, based on historical patterns;
- Potential trade flows, based on a prospective of development patterns if regional connectivity were significantly enhanced;
- Environmental and social sustainability, giving special consideration to the adequate treatment to the region’s extraordinary biodiversity, forest reserves, ecologically fragile areas, and areas where non-contacted human groups live.

These considerations led to the definition of two IDHs encompassing the main integration dynamics already established, exhibiting higher population densities, clear patterns of regional trade and physical articulation, as well as regional institutions for integration. These are the Mercosur-Chile Hub and the Andean Hub.

A second group of eight “emerging” IDHs was also defined, having a potential for regional business growth but constrained by the lack of integration infrastructure. These IDH are all linked to the more consolidated hubs and also incorporate Guyana and Surinam to the process.

For each of these hubs, the countries involved exchanged information on the situation of the energy, transportation and telecom integration infrastructure, and carried out a collective analysis of the territory, in order to identify key bottlenecks and missing links. This work led to the formulation of the IIRSA portfolio, composed of 40 groups of projects — a set of projects with a common strategic function — including 335 projects representing investments for a total of about US\$ 37 billion over a 10 year period.

The action of CAF in infrastructure

Over the last 15 years, CAF has been giving special attention to the infrastructure needs of its member countries, which has been reflected in an extraordinary growth of its portfolio of transport, energy, water and sanitation, and social infrastructure projects. Today, these sectors take up about 70% of its total portfolio, making CAF the main financier of infrastructure projects in the Andean countries and their connections to Mercosur.

Within CAF’s infrastructure portfolio, physical integration projects have an important and growing space,

Integration and Development Hubs in South America



since the support to regional integration is the first pillar of CAF’s mission. The second pillar — sustainable development — stamps a special character to the way in which the Corporation supports the process for integration, striving to protect the region’s unique ecological assets and assisting regional authorities in the strengthening of the national institutions for development planning and implementation, seeking benefits from development for future as well as present generations. For infrastructure projects, this means paying attention to the vulnerability of the territory when selecting technological options and investment priorities, and committing our clients and partners to adhere to the most appropriate social and environmental practices and standards in the implementation of projects. These values are also reflected in the dialogue with governments and private sector, where preferential attention is given to integration projects and the sustainability of development efforts. Since the launching of the IIRSA Initiative, CAF has approved new financing of about US\$ 3,500 million to over 45 integration infrastructure projects, for total investments of more than US\$ 8 billion.

The construction of South American integration is a challenge that requires complex and sustained efforts over a long period of time. CAF is firmly committed to accompanying the countries of the region in these efforts, providing versatile and timely instruments for the financing of investment projects, and contributing to the experience and new capabilities that the region is generating. ●

Antonio J. Sosa, Corporate Vice President, Infrastructure
Francisco J. Wulff, Principal Executive, Infrastructure

Working with the People of Latin America

Social Responsibility

These are difficult times in the Andean region. Widespread poverty, high unemployment, corruption, crime, inequality and exclusion are alarming and discouraging. Politicians, governments and multilateral organizations are all trying to launch social policies aimed at alleviating these dire conditions. They have made progress in some areas, but not at the speed that the situation demands. More fortunately, while this high-level activity is taking place, small initiatives at a micro-level with the cooperation of Corporación Andina de Fomento, CAF, are sprouting throughout the region.

Indigenous women in small hamlets like Chimborazo, Ecuador, or in Morochata, Bolivia, are focusing on reproductive and sexual health through training that incorporates basic principles of anatomy, physiology and pregnancy. They complement this training with informal meetings, plays, rituals and entertainment events that facilitate social interaction and the open discussion of problems and suggested solutions. In the little towns of Esmeraldas, Ecuador and Chincha, Peru, soccer games work as a powerful tool to promote inclusion. Soccer games draw children, young adults and citizens of African descent into activities that they would otherwise be excluded from, including access to nutrition and health information and professional counseling on civic values, fair play, domestic violence and sex education. In addition, the participation of girls has helped promote ideas of recognition and gender equality in communities where women are subordinated.

Another example is musical education, which has become a driving and cohesive force that strengthens self-esteem and civic attitudes throughout the Andean region. It also acts as a preventive tool against drugs, street crime and idleness while improving analytical and learning skills in young people. In Colombia and Peru, successful models of community networking and organization, in alliance with local authorities, have promoted productive initiatives to allow residents to manage and implement their own projects. Local cooperation is not limited to economic activity but includes training, technical assistance in setting up small companies, and the strengthening of social bonds, all of which create a shared vision of the future. In Venezuela, informal savings groups among the poor — or “bankomunales” — have helped the poor secure funds and share resources in communities that have no access to traditional credit. Such loans are managed informally without the supervision of the state and the banking sector. More important, a way of life is organized around the importance of savings and investment as a self-sustainable moral discipline that builds an individual’s reputation and sense of accountability.

The above examples are part of a complex picture of initiatives across countries, communities, and di-

mensions of human development. But is there any larger meaning to them? The Corporación Andina de Fomento, CAF, believes these programs can be the seeds of future solutions in addressing problems of inequality and empowerment. They have not been invented by bureaucrats but created, nurtured and developed by the people themselves. What CAF does is simply to support and strengthen people’s choices and their capabilities, promoting organization and community building as key contributions to sustainable development. Tools such as sports and musical education, the promotion of local cooperation and the creation of a financial culture are helping to drive peoples’ attitudes and behavior toward a commitment of collective good. They play a crucial role inside the social fabric by rescuing intangible strengths such as mutual trust, self-esteem, friendship, dignity, solidarity, discipline, and other shared values that contribute to self-recognition and empowerment.

All of CAF’s socially responsible projects encourage inclusive and active participation of poor communities through dialogue and deliberation. The main reason behind this approach is that the community must be the central agent of policy design and implementation, because community involvement helps sustain a healthy dynamic. People are free to exercise their choices, participate in the decision making on issues that affect their lives, and most importantly, get results that conform to their own idea of welfare.

Beyond the community level, local and regional governments need to participate as well so that successful initiatives can be scaled up and public policies be influenced by this bottom-up approach. There is a central role for the public sector that requires understanding and experiencing the local context that can make policies more responsive to improving the conditions of the poor.

The challenges are huge. Not only is the region’s inequality very high, but changing aspirations and capabilities make the distribution of power a difficult task. Development is not easy. It requires that people have the right to have a voice and that the state become involved at all levels, particularly local, so that policies fit the needs and interests of those receiving public aid. It involves a permanent component of learning and experimentation on both sides of the equation. Social change needs sustained efforts over the long-term on the part of donors and multilateral organizations, as well as flexible management through an on-going process of planning, implementation, and monitoring of activities hand in hand with the community. Last but not least, it calls for a more egalitarian political culture that advocates both the recognition and effective exercise of social, civil and political citizenship. •



Children work on computers at a city-run center in a poor section of São Paulo.

Tools such as sports and musical education, the promotion of local cooperation and the creation of a financial culture are helping to drive peoples’ attitudes and behavior toward a commitment of collective good.

“Working with the people of LA”: Ana Mercedes Botero, Head of the Office of External Relations



CAF

US\$
250 million

YANKEE BOND

May 2005

CAF

JPY
20,000 million

SAMURAI BOND

July 2005

CAF

US\$
150 million

CONDOR BOND

July 2005

Financing and Supporting Development through External resources and local Capital Markets

CAF

COP\$
272 billion

COLOMBIAN LOCAL
MARKET BOND

June 2004

CAF

US\$
150 million

CONDOR BOND

July 2005

CAF

PEN
248 million

PERUVIAN LOCAL
MARKET BOND

May 2006

CAF

VEB
215 billion

VENEZUELAN LOCAL
MARKET BOND

June 2006

This announcement appears as a matter of record only

