Sustainable Development

Inter-American Investment Corporation

2002 Annual Report

Resource Mobilization

Development Finance Institution Support

Institution Building

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Private Initiative

THE INTER-AMERICAN INVESTMENT CORPORATION (IIC) is a multilateral organization. It began operations in 1989 to promote the economic development of its Latin American and Caribbean member countries by financing private enterprises.

To fulfill its mission, the IIC provides project financing in the form of direct loans and equity investments, lines of credit to local financial intermediaries, and investments in local and regional investment funds. It particularly targets small and medium-size companies that have difficulty obtaining financing from other sources on reasonable terms.

In a sense, IIC finance is seed money. The Corporation serves as a catalyst for attracting other resources: additional financing, technology, and know-how. These resources are mobilized through cofinancing and syndication, supporting security underwritings, and identifying joint venture partners.

Lending and investing require evaluation of project soundness and probability of success. In this preliminary evaluation process, the IIC advises clients on project design and financial engineering and helps them to structure their financial plan.

To obtain IIC financing, projects must offer profitable investment opportunities. They must also further economic development in some way—by creating jobs, broadening capital ownership, generating net foreign currency income, facilitating the transfer of resources and technology, utilizing local resources, promoting local savings, or promoting the economic integration of Latin America and the Caribbean. Any environmentally sensitive project must include specific preventive or restorative measures.

All the powers of the Corporation are vested in its Board of Governors. The IIC Board of Governors consists of a representative and an alternate from each member country. Voting power is proportional to each country's paid-in shares. The Board of Governors appoints a Board of Executive Directors to which significant authority and powers are delegated.

The Corporation is affiliated with the Inter-American Development Bank Group. The IIC is legally autonomous, and its resources and management are separate from those of the Inter-American Development Bank.

Member Countries:

Argentina
Austria
Bahamas
Barbados
Belize
Bolivia
Brazil
Chile
Colombia
Costa Rica
Denmark
Dominican Republic
Ecuador
El Salvador
Finland
France
Germany
Guatemala
Guyana
Haiti
Honduras
Israel
Italy
Jamaica
Japan
Mexico
Netherlands
Nicaragua
Norway
Panama
Paraguay
Peru
Portugal
Spain
Suriname
Sweden
Switzerland
Trinidad and Tobago
United States
Uruguay
Venezuela

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7 February 2003

Chairman of the Board of Governors
Inter-American Investment Corporation
Washington, D.C.

Mr. Chairman:

Pursuant to the provisions of Article IV, Section 9(a) of the Agreement Establishing the Inter-American Investment Corporation, I transmit to you the Annual Report of the Corporation for 2002 and the audited financial statements, including the balance sheet, income and retained earnings statement, and cash flow statement for the fiscal year ending 31 December 2002.

Yours sincerely,

Enrique V. Iglesias
Chairman
Board of Executive Directors
Inter-American Investment Corporation

The year in review

Latin America and the Caribbean in 2002: economic overview

In 2002, the nations of Latin America and the Caribbean went through one of the most difficult economic periods of the region's recent history. This crisis, the most severe and widespread since the debt crisis of the early 1980s, affected all of the region's countries to some degree. Even those economies that grew did so at a slower than usual rate or, in several instances, below the population growth rate. In this context and in view of the uneven performance of the area's productive sector since the late 1990s, gross domestic product (GDP) per capita in Latin America and the Caribbean has been falling for half a decade now.

But the crisis was not limited to Latin America and the Caribbean. The economic picture in the region was further complicated by the slowing economy in the United States (the region's main trading partner), Europe's difficult economic integration due to member countries' various business cycles, and the persistent recession in Japan.

Ripple effect

With the three major engines of worldwide growth in economic difficulty, Latin American and Caribbean exports declined in an environment in which the prices for their chief products were still low. Lower export sales and lower commodity prices inevitably led to a fall in export revenues and, in turn, to worsening trade and current account balances in some countries. Because external financing for the region has traditionally been scarce and volatile and direct foreign investment has fallen since the end of the 1990s, the seesawing exchange rates throughout the region during the year came as no surprise.

Another effect of the worldwide economic slowdown is a sharp decline in capital flows to Latin America and the Caribbean overall. According to the Economic Commission for Latin America and the Caribbean, capital inflows for 2002 will be in the area of $50 billion, down sharply from the $74 billion average for 1996 through 1998; the net flow of resources has been negative for the fourth year in a row for the region as a whole. Most of this decline is due to a drop in foreign direct investment. In addition, wariness on the part of international banks and investment portfolio managers has halved the equity funding committed to the region, which has gone from $808 million in 2001 to a projected $427 million in 2002 following an even sharper drop between 2000 and 2001.

This curtailment of external financial capital disproportionately affected the sector that traditionally has had the hardest time accessing such funding: small and medium-size enterprises.

The IIC in 2002

Effects of the economic crisis in the region

Regional economic trends and the slowing of the global economy affected the Corporation as well. Its operating portfolio and its results for 2002 were both influenced by the worsening business climate, which could extend into 2003. Moreover, falling interest rates in the United States have diminished the return on the IIC's liquid portfolio and its ability to generate income that could offset losses in other operating areas.

The risk for new operations increased as well, in a climate of rising local currency interest rates, increasing foreign exchange risk and perceived legal uncertainty, and a marked drop in sources of hard currency credit. All of these factors influence the present performance and future prospects for small and medium-size companies and, thus, the Corporation's performance.

Although current economic conditions do make the IIC's mission more difficult, they also underscore the importance of its role as an institution that can help the region's small and medium-size companies weather the crisis that affects them disproportionately.

Core operations

This year, the IIC's Board of Executive Directors approved twenty projects in fifteen countries—plus four regional projects—totaling $123.3 million. Seven percent of the funds approved were for equity investments and 93 percent were for loans. The year's two equity investments went to developmentally oriented regional investment funds. These funds have a total capitalization of $110 million, providing a 12.2:1 leverage of the IIC's own equity investments for the year. One of the loans will be cofinanced; this operation will mobilize a total of $8.5 million in funding from banks and other third parties.

The year's approvals followed identification of 379 potential projects in 25 countries; 209 were not considered because they did not meet basic IIC criteria regarding size, additionality, or perceived risk, among others. The remaining 170 passed on to subsequent phases. As a result, twenty transactions were submitted for consideration and approval by the Board of Executive Directors.

Financial results

IIC income from all sources in 2002 amounted to $19 million. Income from lending operations totaled $14 million ($12 million from interest and $2 million from fees). Capital gains and dividend income from the equity investment portfolio totaled $2 million for the year. Total expenses, including $44 million in provisions, were $60 million, producing a net loss of $41 million.

Regional economic conditions led to recognition of increased risks and related loss provisions in the Corporation's portfolio during 2002.

Developmental impact

It is expected that year 2002 approvals will lead to the creation of more than 9,000 jobs, generate annual exports worth $225 million, and contribute $168 million per year to the region's GDP. The $123.3 million approved in 2002 will support the implementation of projects with a total cost of $317 million. For every dollar earmarked by the Corporation for year 2002 approvals, 2.6 dollars will go to investment projects.

Since it began operations in 1989, the IIC has channeled funding to more than 3,500 beneficiaries in the productive and service sectors in Latin America and the Caribbean. Projects with an aggregate cost in excess of $8 billion have been undertaken thanks to the $850 million in funding provided by the IIC in the form of loans and equity investments and the $400 million in funding that the Corporation mobilized through cofinancing arrangements. For each dollar that the IIC has invested, nine dollars are going to companies that have created approximately 215,000 jobs and generate $3 billion in foreign currency for the region each year. Operations in countries with larger economies amount to $667 million, while those in the smaller economies of the region total $387 million (i.e., 63 percent and 37 percent of the portfolio, respectively). Projects with regional coverage total $241 million. Of the IIC's committed investments, 87 percent had been fully disbursed by 31 December 2002.

Governing body activities

Board of Governors

All of the powers of the Corporation are vested in its Board of Governors, which is composed of one Governor and one Alternate Governor appointed by each member country. Among the powers vested in the Board of Governors that it cannot delegate to the Board of Executive Directors are the admission of new member countries, the engagement of external auditors, approval of the Corporation's audited financial statements, and the amendment of the Agreement Establishing the IIC.

The Board of Governors holds an annual meeting in conjunction with the annual meeting of the Board of Governors of the Inter-American Development Bank (IDB). It may meet on other occasions by call of the Board of Executive Directors.

The XVII Annual Meeting of the Board of Governors took place in Fortaleza, Brazil, from 11 to 13 March 2002. During this meeting, the Governors approved the IIC's financial statements for the year ended 31 December 2001, as well as the Corporation's annual report. The Governors also approved an amendment to remove the Charter requirement that a majority of the voting power of the enterprises in which the Corporation invests be held by investors who are citizens of its regional member countries. The Governors also requested that an external review group be created to review the Corporation's current situation and its programs and policies for the future.

Board of Executive Directors

The Board of Executive Directors is responsible for the conduct of the operations of the Corporation and for this purpose exercises all of the powers given to it by the Agreement Establishing the IIC or delegated to it by the Board of Governors. The thirteen members and thirteen alternate members of the Board serve for three-year terms and represent one or more member countries of the Corporation.

The four-member Executive Committee of the Board of Executive Directors considers all the Corporation's loans to and investments in companies located in member countries.

In 2002, the Board of Executive Directors considered

- twenty loan and equity investment proposals
- amendments to the IIC's operating, financial, and investment policy regulations concerning geographical balance and diversification of operations in regional developing member countries; the applicable law of the Corporation's legal documents; types of financial instruments; protection of IIC interests; security; loan pricing and fees; and portfolio risk diversification
- an amendment to the regulations of the Board of Executive Directors that modified the short procedure process for approval of new loan and equity investment operations
- the IIC funding program for 2002 and strategy for 2002-2003
- the appointment of and terms of reference for an external review group
- the policy and operational guidelines for an independent investigation mechanism for the IIC
- human resources management strategy and general guidelines
- the final report on the Finpyme program (Financiamiento Innovador para Pequeñas y Medianas Empresas)

Other permanent functions

Independent evaluation
The need to develop objective indicators (which are essential for public accountability in the use of public funds and for learning from experience, establishing success standards, and reinforcing corporate objectives and values) led the IIC to implement a project evaluation system based on guidelines developed by the multilateral development banks' Evaluation Cooperation Group. The evaluation function is divided between self-evaluation and independent evaluation. Project self-evaluation is the responsibility of IIC investment officers. The IDB's Office of Evaluation and Oversight provides the IIC with independent evaluation services under an agreement between the two institutions. In March 2002, the Office of Evaluation and Oversight presented to the IIC Board of Executive Directors preliminary evaluation results on a group of twenty projects; results for twenty-five more projects will be presented by March 2003.

In 2002, the Evaluation Co-operation Group benchmarked the practices of each member organization against the agreed good practice standards. The IIC's evaluation methodology and progress in implementation received a high rating.

Portfolio and credit risk management
Effective, productive deployment of the resources subscribed by the IIC's shareholders involves sound portfolio management that takes into account primarily the two main types of risk to which the IIC's project companies are subject: macroeconomic risk and credit risk.

Macroeconomic risk is largely beyond the control of the IIC and its clients. However, the appraisal process prior to project approval takes this risk into account and is geared to avoiding situations in which the potential risks would make it virtually impossible to attain the IIC's developmental goals or recover its assets.

The Corporation's Credit Unit provides the Credit Committee with an assessment of each project company's credit risk and transaction structure, including a review of the security package. The committee is responsible for recommending to the General Manager whether to present projects for Board consideration, and it thus focuses primarily on credit issues and on ensuring that loans and investments are structured in accordance with the project company's risk profile.

Noncredit issues, such as project developmental and environmental impact, international private sector and capital markets resource mobilization, and IIC policies, are central to IIC's mandate and are taken into account in the process of deciding whether to submit a project to the Board of Executive Directors. To this end, input on these aspects of each project proposal is received from relevant areas prior to the final Credit Committee meeting.

Anticorruption measures
The IIC places great importance on transparency in its financing operations, which therefore undergo a rigorous due diligence process and are required to follow sound financial management practices. For each financing operation, the IIC assesses the beneficiary's financial reporting and controls and management capabilities, including the critical risks—such as corrupt practices—to which the beneficiary may be subject.

With the increased focus on the risks of corrupt activities within banking and financial systems, the IIC reviews each host country's regulations pertaining to money laundering and assesses each financial institution's compliance with such regulations (if any) and the adequacy of its controls with respect to deposit taking and management activities.

To buttress these efforts, the Board of Executive Directors approved an institutional framework to strengthen the IIC's ability to combat fraudulent practices and the risk of fraud and corruption in its activities. In this context, the Board approved the proposal that the IIC form part of the IDB's recently established oversight committee to deepen the synergies between both institutions and to more closely align IIC action on and efficient implementation of policy with the IDB Group regarding allegations of fraud or corruption.

Project supervision
To reinforce this key aspect of corporate governance, during 2003 Management

will implement organizational changes in order to pursue more effectively the IIC's developmental mandate while improving operating efficiency and asset quality. All portfolio supervision functions will be transferred from Operations to a single Portfolio Management Unit that will concentrate on the active management of normal portfolio companies.

Problem projects are transferred from the Portfolio Management Unit to the Special Operations Unit, which for several years has been responsible for maximizing cash recovery of problem loans and investments in an efficient manner.

The Special Operations Unit also contributes to the prevention and early detection of problem projects by participating in the Credit Committee and the Portfolio Supervision Committee. The unit also advises project officers on projects that are experiencing initial problems and regularly reports to the officers on the lessons learned from problem projects.

On a governance level, a Special Ad-Hoc Committee of the Board of Executive Directors provides a forum for discussing recovery action plans at an early stage. Through the committee, the IIC keeps its Executive Directors informed and seeks their guidance at critical junctures of negotiations with impaired project companies.

Cooperation with the IDB

Combined action with the IDB can be a powerful agent for development in Latin America and the Caribbean. The general thrust of IIC's coordination with the IDB is in the development of the private sector segments of country strategies and programming. To this end, the IIC participates in the Private Sector Coordination Committee. The IIC's Chief Credit Officer advises the IDB's Executive Vice President on credit risk assessment regarding IDB Private Sector Department projects. IIC staff members also serve on the Private Sector Department's Credit Review Group and on the Bank's loan committee for private sector operations. Also, the IIC's Credit Committee is in effect the "investment committee" for Multilateral Investment Fund operations in the latter's equity investment approval process.

Multilateral Investment Fund

The Multilateral Investment Fund (MIF) was established in 1992 to promote the economic and social viability of market economies in Latin America and the Caribbean. The MIF is administered by the Inter-American Development Bank and engages the IIC to provide certain services. In 2002, the Corporation supervised several projects for the MIF, participated in the structuring and due diligence of small business investment funds, and provided oversight on the preparation of new MIF investments.

Decision-making committees

Credit Committee

The Credit Committee reviews all new operations and makes recommendations to the General Manager as to whether they should be submitted for approval by the Board of Executive Directors. The committee is chaired by the Chief Credit Officer; the vice chairman is the Chief of the Finance Division. Other members are the Chiefs of the Corporate Finance and Financial Services Divisions and the Chief of the Special Operations Unit.

Portfolio Supervision Committee

The Portfolio Supervision Committee assigns risk ratings to all existing operations based on annual supervision reports. It calculates provisions on the basis of these ratings and decides when operations should be transferred to the Special Operations Unit. The chairman of the committee is the Finance Division Chief. Other permanent members are the Chiefs of the Corporate Finance and Financial Services Divisions, the General Counsel, the Chief Credit Officer, the Senior Special Operations Coordinator, and the Senior Portfolio Officer.

AIG-GE Capital Latin American Infrastructure Fund
The IIC continued to lend its regional expertise as an adviser to the Emerging Markets Partnership for its fund investments in infrastructure companies in Latin America, chiefly in the power, transportation, and telecommunications sectors. The Emerging Markets Partnership is the principal adviser to the AIG-GE Capital Latin American Infrastructure Fund (LAIF). During the year, the IIC provided advisory and monitoring services for nineteen projects.

Other special funds
The Corporation can also draw on special funds for studies and other activities. Among these funds are the Austrian Fund, the Italian Trust Fund, the Spanish Trust Fund, the Swiss Fund, the United States Trade Development Agency's Evergreen Fund, and the United Nations Program for the Environment. In addition, cooperation agreements are in place with the Centre for the Development of Industry (financed by the European Development Fund under the Lomé Convention), the Government of Austria and Finanzierungsgarantie-Gesellschaft mbH, and the Nordic Development Fund. Some $150,000 in technical cooperation funds were channeled through the IIC during 2002.

New developments

The partnership grows
Finland, Norway, and Portugal became member countries of the Corporation in signing ceremonies held in January, March, and July, respectively. Belgium is expected to complete the process by the time this annual report is released.

Loan from Shinkin Central Bank
Late in the year, the IIC signed a $30 million, seven-year loan agreement with Shinkin Central Bank (with Mizuho Corporate Bank, Ltd., as agent bank). The IIC will use the proceeds to provide financing for small and medium-size companies in Latin America and the Caribbean.

Credit ratings
Standard & Poor's maintained the IIC's AA counterparty credit rating this year. The rating agency stressed both the unique difficulty of the IIC's mandate and its importance in the region, where more than 90 percent of the manufacturing firms are small or medium-size. According to Standard & Poor's, the increase in the IIC's paid-in capital approved by its shareholder countries

OF PARTICULAR NOTE are two projects approved this year. The $7 million loan to Exportadora Subsole, S.A., in Chile will exercise a remarkable multiplier effect by providing about one hundred small fruit growers with new technology, advice on agricultural and business matters, and, for some, financing for planting or harvesting their crops. Selling their crops through Subsole will also enable the growers to receive a better price than if each one were to deliver fruit directly to the exporters. This is the first financing project approved for a company that underwent the selection and diagnostic review process under the Finpyme (Financiamiento Innovador para Pequeñas y Medianas Empresas) methodology.

The $10 million loan to Mexico's Instituto Superior Autónomo del Occidente, A.C.-UNIVA, is a good example of the IIC's role as lender of last resort. The IIC is providing long-term funding on appropriate terms to a sector—education—in which private banking in the region has historically shown little interest. The loan will help a private educational institution provide a basic service that fosters development without using taxpayer money.

For more details on these projects, see the Developmental Investment Activities section of this annual report.

In Costa Rica, the Matamoros group of power-generating companies, including the Hidroeléctrica Platanar project, which received an IIC loan in 1994, received ISO 14001 environmental management certification. This is the first time an energy company in Latin America has received this certification.

Not only does this group of companies generate a considerable amount of electric power for Costa Rica, they enable it to avoid importing 37 million liters of diesel fuel each year and offset the equivalent of 107,000 tons of greenhouse gases. This means considerable savings for Costa Rica without involving public monies.

in 1999 is in effect an acknowledgement of this key role. Moody's Investors Services also maintained the IIC's Aa2 rating, in view of its strong capitalization and sound management, conservative financial accounting practices, and strong shareholder support.

Appointment of external review group

Late in the year, the Chairman of the Corporation's Board of Executive Directors appointed an external review group to examine the future strategic directions and priorities of the Corporation. The group, composed of recognized authorities with banking, private business, and multilateral and other development finance institution experience, will assess how the business environment for Latin America's small and medium-size enterprises has been affected by changes and trends in the world economy. Its findings will be the basis for the group to ascertain and recommend strategic directions to maximize the IIC's developmental effectiveness and corporate profitability, given the capital and human resources entrusted to the institution.

The members of the group are Messrs. Richard Aitkenhead (Guatemala), Patrizio Bianchi (Italy), Jon E. Blum (United States), Andréa Calabi (Brazil), Nicolas Imboden (Switzerland), Arthur Lock-Jack (Trinidad and Tobago), Miguel Kiguel (Argentina), Pedro-Pablo Kuczynski, Chairman (Peru), Leiv Lunde (Norway), Italo Pizzolante (Venezuela), and Enrique Tierno (Spain).

Additionality roundtable

In May, the Inter-American Investment Corporation and the International Finance Corporation sponsored an interagency roundtable on additionality. Representatives of international development institutions (including the Andean Development Corporation, the Caribbean Development Bank, the Central American Bank for Economic Integration, the Commonwealth Development Corporation, Compañía Española de Financiación del Desarrollo, Ecuador's Corporación Financiera Nacional, Chile's Corporación de Fomento de la Producción, Germany's Deutsche Investitions-und Entwicklungsgesellschaft, the European Bank for Reconstruction and Development, the European Investment Bank, Finanzierungsgarantie-Gesellschaft of Austria, the Multilateral Investment Fund, the North American Development Bank, and the U.S. Overseas Private Investment Corporation) met to examine the issue of "additionality," whereby public international assistance institutions encourage private sector-led growth through policies and activities such as financing, guarantees, insurance, equity positions, and technical assistance to promote stronger and more transparent regulatory frameworks.

Other areas of additionality discussed were the promotion of greater inclusiveness and fairness and support for microfinance and small and medium-size enterprises. Speakers noted that the need for better measuring the results of assistance by development institutions, particularly in the area of private sector-led growth, was among the topics stressed last March during the meeting of the heads of state in Monterrey, Mexico.

In inaugurating the roundtable at the headquarters of the Inter-American Development Bank in Washington, D.C., Enrique V. Iglesias, President of the IDB and Chairman of the Board of Executive Directors of the IIC, said the "challenge of optimizing and accounting for additionality benefits" is key to explaining the relevance of development institutions for emerging economies, where "private initiative and financial markets are increasingly relied upon as the major force for economic advancement."

The IIC explained its recent initiative to develop an "additionality framework" for the appraisal and monitoring of its lending and equity investment operations based on the six pillars of development support highlighted on the cover of this annual report: sustainable development, resource mobilization, development finance institution support, institution building, corporate governance, and private initiative. All of the presentations made during the roundtable are available on the IIC Website (www.iic.int).

IFC–IDB group meeting

In October, the International Finance Corporation and the institutions affiliated with the Inter-American Development Bank held a special meeting to discuss the economic situation in Latin American countries. The meeting focused on the problems encountered by the private sector and how activity levels are affected by the ongoing crisis. The institutions discussed the strategies, beyond traditional means of support, that they could follow to support the private sector and the instruments best suited to help private sector companies deal with the economic slowdown and weather the restricted access to funding. Also on the agenda were ways to respond to the crisis in Argentina, possible joint actions to help improve the business climate in Latin America and the Caribbean, and ways to improve private sector access to suitable sources of funding. Another topic was the possibility of providing funding for external trade operations.

Italian Special Trust Fund for the sustainable development of small and medium-size enterprises in Argentina

The Italian government has designated the IIC to provide oversight of the financing operations under a €75 million facility established by Italy and Argentina for supporting small and medium-size companies in Argentina. The IIC will monitor the selection and review process for projects to be financed through the facility.

A team from the IIC will work out of the IDB field office in Buenos Aires in close cooperation with Argentina's Secretaría de PYMES and Banco de la Nación, to fund projects that foster job creation or preservation, are located in preferential areas, and are export-oriented.

Small Loan Program

The IIC, like other institutions serving small and medium-size companies, must provide credit products that meet the special needs of this market segment in a cost-effective manner for both the borrower and the lender. For years, the IIC has processed many smaller loans through its credit lines and, more recently, agency lines extended to financial institutions operating in the region. But exclusive reliance on such arrangements has limited the IIC's ability to serve the needs of small and medium-size companies in all of its borrowing member countries. Serving this market requires a responsive and proactive approach, a simpler and faster credit analysis and approval process, and access to long-term financing at appropriate rates.

The IIC will thus offer loans in the range of $150,000 to $1,500,000 during a two-year Small Loan Program pilot period, with a limit of $20,000,000 in total approvals. The IIC will launch the pilot program in Bolivia, Costa Rica, and El Salvador (to take advantage of the IIC's field presence in Central America) and build on the Finpyme pilot program in Bolivia and Chile; it may extend the program to other countries at the end of the first year. Two years after the original launch date, Management will present a report to the Board with an evaluation of the Small Loan Program. For more information on the small loan program, see the Developmental Investment Activities section of this annual report.

Environmental issues

In February and September, a total of sixty representatives from forty financial institutions in thirteen Latin American and Caribbean countries attended an IIC-sponsored environmental management workshop. This year's workshops were cohosted by the International Finance Corporation and Corporación Andina de Fomento as part of an interinstitutional effort to step up cooperation and simplify the transmittal of information to mutual clients.

All financial intermediaries with which the IIC operates are required by contract to attend these workshops to learn how to integrate environmental management practices into their own operations and turn good environmental practices into competitive advantages. The workshops focus on banks' responsibility in monitoring the environmental aspects of the projects they finance with IIC funds.

Looking ahead

The year 2002 was a difficult one for the region and thus for the Inter-American Investment Corporation. The negative impact of the economic situation in the region is reflected in the Corporation's operating results, because some of the companies with which the Corporation works had serious difficulties. Unfortunately, the outlook for 2003 is no more promising.

But the challenges posed by this negative outlook should lead the IIC to work harder, smarter, and more creatively to achieve the desired results. As the new situation unfolds, the IIC must be proactive while still being careful to grant financing to projects that foster sustainable development.

This adverse environment will hurt small and medium-size companies. The IIC will have to support them—seeking to preserve the value of its own assets—with restructurings that will require imagination in addition to determination. That is the IIC's commitment.

Small and medium-size enterprises are the largest source of employment in the Latin American economies; they account for more than 50 percent of the region's GDP. Therefore, the IIC must put together institutional networks to support them and make them viable, particularly in times of recession and uncertainty, when it is far more difficult to access credit. The challenge will be to build broad commercial, productive, logistical, service, and financial networks for the sustainable growth of small and medium-size companies, which are the driving force behind versatility, creativity, and continuing development in Latin America and the Caribbean. The IIC must provide these companies with new and better incentives in difficult situations like this one. Doing so will require an effort on two fronts: the IIC must ensure its own sustainability and fill more of the unmet demand for the funding it provides. To rise to this challenge, the IIC must become more profitable, improve portfolio and problem project management, implement new financial instruments that meet the region's changing needs while increasing the IIC's volume of operations and revenue, and increase its portfolio in the Caribbean.

The problems that Latin America and the Caribbean are facing make it more important than ever to seek out ideas, guidance, and directives that will enable the IIC to constructively set its course and renew its commitment to progress in the region.

Jacques Rogozinski
General Manager
Inter-American Investment Corporation

Developmental investment activities

Sources of funding

The IIC has several sources of funding: paid-in capital, borrowings, income on investment of liquid assets, and amounts received upon the sale of investments or the repayment of loans. The IIC's capacity to make loans and equity investments is a function of its paid-in capital and borrowings; borrowings are limited by the Charter to three times paid-in capital.

Target market and eligibility requirements

The IIC's developmental financing program targets small and medium-size private companies in Latin America and the Caribbean that have limited access to long-term financing. This financing is in the form of direct loans, direct equity or quasi-equity investments, lines of credit to local financial intermediaries for on-lending in the form of smaller loans, agency lines with local financial institutions for joint lending, investments in local and regional private equity funds, and guarantees for and investments in capital markets offerings.

IIC loans are denominated in United States dollars. Loan amounts may be up to 33 percent of the cost of a new project or up to 50 percent of the cost of an expansion project. Loan terms generally range from five to eight years (up to a maximum of twelve years), including an appropriate grace period. The loans, which are priced in accordance with international market conditions, are usually variable in rate and based on the London Interbank Offered Rate (LIBOR). In certain cases, the IIC may provide convertible, subordinated, participated, or fixed-rate loans.

The IIC also makes equity investments of up to 33 percent of the investee company's capital. At the end of the investment period, the IIC sells its shareholding. Possible exit mechanisms include sale on the local stock market, private placement with interested third parties, and sale to the project sponsors under a prenegotiated share purchase agreement. The IIC also invests in equity capital funds whose operations have a positive developmental impact in the region. Doing so makes efficient use of the IIC's equity resources to reach many more small and medium-size companies. Working through equity funds also promotes mobilization of capital by bringing in other institutional investors. The IIC may make quasi-equity investments as well.

The IIC's target market comprises companies with sales ranging from $2 million to $35 million. However, the IIC works selectively with companies having sales in excess of $35 million. On a limited basis, the IIC also finances joint venture companies. While profitability and long-term financial viability are prerequisites for IIC financing, other selection criteria the IIC will consider are related to the company's impact on factors that further economic development.

The IIC also provides funding to all types of financial institutions that serve the small and medium-size company market. Eligible institutions include, but are not limited to, commercial banks, leasing companies, finance companies, and specialized financial service companies.

The IIC's Website (www.iic.int) provides detailed information on how to apply for financing. Requests for information may also be addressed to the IIC's regional offices or its head office in Washington, D.C. The Website also provides an initial inquiry form that, once filled out by the company or financial institution in search of funding, is automatically directed to the appropriate IIC division.

Operations in 2002

In keeping with the practice followed by other development finance institutions, this year the IIC is for the first time presenting the year's operations in a format that more closely reflects the complete impact of its financing activities. In addition to direct project approvals, there is more detailed information on the subloans, subinvestments, and cofinancing operations approved in 2002 that, through financial intermediaries, substantially leverage the resources provided directly by the IIC. In prior years, these operations were not broken down but rather were included in the aggregate figures given, in narrative form, in the section titled "The Year in Review."

Also provided are figures on procurement opportunities for borrowing and nonborrowing countries ($170 million in 2002).

Fourteen of the direct operations described below* include loans totaling $67 million. This year's cofinanced loan will mobilize an additional $8.5 million in funding, and the two investment funds in which the IIC acquired an equity participation will further leverage the resources available for the region's small and medium-size companies. The total cost of the projects financed as a result of the operations approved by the IIC in 2002 is $317 million.

* Operations through agency lines are set in *italics*.

REGIONAL

Equity investment: $3 million
Average subinvestment: $3 million

Aureos Central America Fund L.L.C. (ACAF) is a private equity fund that will invest primarily in small and medium-size companies in Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, and Panama. The fund's target capitalization is $50 million. For many years, ACAF has successfully raised equity capital for medium-size private enterprises in Central America and Panama. It is sponsored by Aureos Capital Limited L.L.C., a private limited liability company that is jointly owned by the Norwegian Investment Fund for Developing Countries and CDC Capital Partners. ACAF expects to invest in seven to fourteen small companies, especially ones that are likely to benefit from industry consolidation or increased domestic consumer purchasing power as a result of greater regional integration. Investing in ACAF will leverage the IIC's participation by twelve to one, enable it to target key economic sectors for the development of an integrated region, and achieve a high demonstration effect.

Equity investment: $6 million
Average subinvestment: $8 million

ProBa Central American Banking Fund, L.P., is a private equity vehicle targeting the rapidly growing financial sector in Central America and Panama. The fund has a target capitalization of $60 million; its sponsors are Darby Overseas Investment Ltd. (a U.S. investment firm specializing in Latin America), The Netherlands Development Bank, and the Central American Bank for Economic Integration. The fund plans to invest in financial institutions that have solid growth prospects but need capital to grow.

Through the ProBa investment, the IIC also seeks to increase the support it provides in Central America and Panama, especially since this region has historically received relatively little attention from foreign investors. The investment will also represent a stake in the market integration efforts of the Central American countries and Panama, facilitate the flow of fresh capital to Central America, and leverage the IIC's resources ten to one.

Loan: $20 million
Average subloan: $825,000

The **Small Loan Program** will enable the IIC to make smaller loans to smaller companies than it can reach through its other financing programs. Companies eligible for loans under this program will have assets equal to or less than $15 million; be incorporated and located in Latin American and Caribbean member countries; be preferably export-oriented or operate in foreign-currency-generating sectors; be engaged in activities that meet IIC's criteria regarding economic development and additionality; and comply with applicable environmental, labor, and occupational health and safety standards. Proceeds from these loans will be used to purchase new equipment or machinery, build or modernize facilities, restructure existing debt, and/or finance working capital. In the specific cases of debt restructuring and working capital financing, certain percentage limits will apply.

Loan: $10 million
Maximum subloan: $2.5 million

Suleasing Internacional, a Panamanian company whose main shareholder is Suleasing Colombia, will use the proceeds of an IIC loan to provide financing to small and medium-size companies in Central America, the Caribbean, and the Andean region via medium- and long-term finance leases for modernizing and expanding those companies. Suleasing expects that 40 percent of its finance lease operations will be in Colombia; the remainder will be in the rest of its target region.

The project will contribute to the modernization of production processes in the region by means of cross-border lease arrangements. It will also increase worker productivity. Labor-intensive industrial and construction sectors account for 40 percent of the operations approved by Suleasing. The company will thus help improve production conditions, providing state-of-the-art technology to labor-intensive sectors.

BELIZE

IIC Loan: $1 million
LAAD Loan: $1 million

With $2 million in funding under a $20 million agency line agreement signed between the Inter-American Investment Corporation and Latin American Agribusiness Development Corporation (LAAD) in 1999, ***Fresh Catch Belize*** *will implement a $4.2 million start-up tilapia-farming project that will create 100 permanent jobs, chiefly for women, as well as 20 seasonal jobs. The project design provides for an environmentally friendly production system and meets all of the environmental and labor requirements of the IIC agency line. The Fresh Catch project—the IIC's first in Belize—also involves the transfer of Israeli tilapia-farming technology and know-how.*

BRAZIL

Loan: $6 million
Total project cost: $33.7 million

ALE Combustíveis S.A., a Brazilian-owned fuel distribution business, will expand its fuel distribution network, which is made up of small and medium-size enterprises that operate gas stations. This expansion will be implemented by acquiring or building 310 environmentally audited gas stations in seven states in Brazil.

Once completed in 2004, this project will generate approximately 2,000 new jobs. Of the funds provided by the IIC, $2.8 million will be used for environmental protection and $800,000 for on-lending to small and medium-size companies that will enter into contracts with ALE to operate eligible gas stations. The remaining $2.4 million will be invested in eighty-five new gas stations.

The IIC will also be supporting the training of small entrepreneurs and unskilled workers, because the expansion plan includes the construction of six new gas station schools. The IIC's loan to ALE is its first to a Brazilian company headquartered in the state of Minas Gerais, helping to decentralize economic activities in Brazil.

CHILE

Loan: up to $7 million
Total project cost: $18.4 million

Exportadora Subsole, S.A., a vertically integrated fruit exporter, is a Chilean exporter of table grapes and other fruit. The company works with approximately 100 small growers as partners, subborrowers, or suppliers. As a group, these growers own or lease approximately 2,000 hectares of land planted with table grapes, citrus fruits, avocados, stone fruits, and kiwis. Subsole organizes its growers, transfers technology to them, and advises them with respect to agricultural and business issues. It finances the harvest and/or plantings of some of its growers.

The first phase of the project calls for providing long-term financing for planting for the small growers who supply Subsole with fruit. The second phase involves financing certain fixed assets, both at Subsole and at some of the small growers. The IIC will provide Subsole with long-term funding, and Subsole will on-lend the funds to the growers. This is the IIC's first loan to a company identified under the Finpyme small enterprise diagnostic review program for screening and evaluating projects and making small and medium-size companies more competitive. The Finpyme program was launched with funding from the IDB's Spanish Fund.

The IIC loan will enable Subsole to create approximately 7,500 temporary jobs per year following project completion in 2005.

COLOMBIA

Loan: $10 million
Maximum subloan: $2 million

Funds from the loan to **Banco de Bogotá** will be used to grant medium- and long-term loans to small and medium-size Colombian companies wishing to upgrade their facilities or expand their operations. Banco de Bogotá's on-lending operations will target companies that operate in the export, retail, transportation, communications, and service sectors and in labor-intensive industries such as manufacturing and construction.

DOMINICAN REPUBLIC

Loan: $5 million
Total project cost: $17.9 million

Abco S.A. will build a cement plant at a new manufacturing facility ninety-eight kilometers southwest of Santo Domingo. The production process will consist of grinding imported clinker with locally produced gypsum. At a later stage, the company will also install a kiln and produce its own clinker.

Bringing a new cement plant on line will help fill the gap between demand and production in the Dominican Republic, which in 2001 imported 11 percent of the cement used that year. The plant will make it possible to substitute local production for part of these imports, resulting in foreign exchange savings. And by providing a major raw material for the construction industry, the project will create ninety-five direct jobs in a labor-intensive economic activity.

ECUADOR

Loan: $5 million
Total project cost: $11.8 million

Aquamar S.A., an aquaculture firm that switched from shrimp farming to tilapia farming, began exporting fresh and frozen tilapia to the United States in 1998 and quickly became a market leader. Tilapia exports have tripled in this rapidly growing market, and Aquamar's technical and space limitations have made it necessary to build a new processing plant. The new, state-of-the-art plant will process the raw material more efficiently and add greater value to the additional production. It will enable a small Ecuadorian company to offer a high-quality product on the U.S. market and compete on better terms with companies from other countries. One hundred percent of the additional production generated by the project will be for export. The project is expected to create nearly 600 direct jobs.

EL SALVADOR

Loan: Up to $4.3 million
Total project cost: $8.9 million

Fundación Empresarial para el Desarrollo Educativo (Fepade) is a private, nonprofit, nonpolitical institution for developmental education founded by well-known Salvadorian companies, banks, and foundations. Fepade provides training seminars, courses, and specialty programs for an average of 5,000 students per year. Some of its programs have been run in cooperation with El Salvador's Ministry of Education and with the United States Agency for International Development. People with low, medium, and high educational levels can participate in Fepade's programs and thus improve their access to the labor market.

The IIC loan—its first to an educational institution in El Salvador—will help build a new campus in the outskirts of San Salvador, on a piece of land donated by the Salvadorian government. The project will create more than thirty teaching positions.

HONDURAS

IIC Loan: $1.5 million
LAAD Loan: $1 million

Granjas Marinas Larvicultura, S.A. de C.V. *(GM) is part of a fully integrated company known as Grupo Granjas Marinas that owns and operates two shrimp farms and a research arm. GM produces and supplies post-larvae white shrimp to group companies and third parties. The proceeds from the loan under the agency line agreement between the IIC and LAAD will replace a short-term loan obtained by GM to finance expansion of a shrimp hatchery; the loan will also provide additional permanent working capital.*

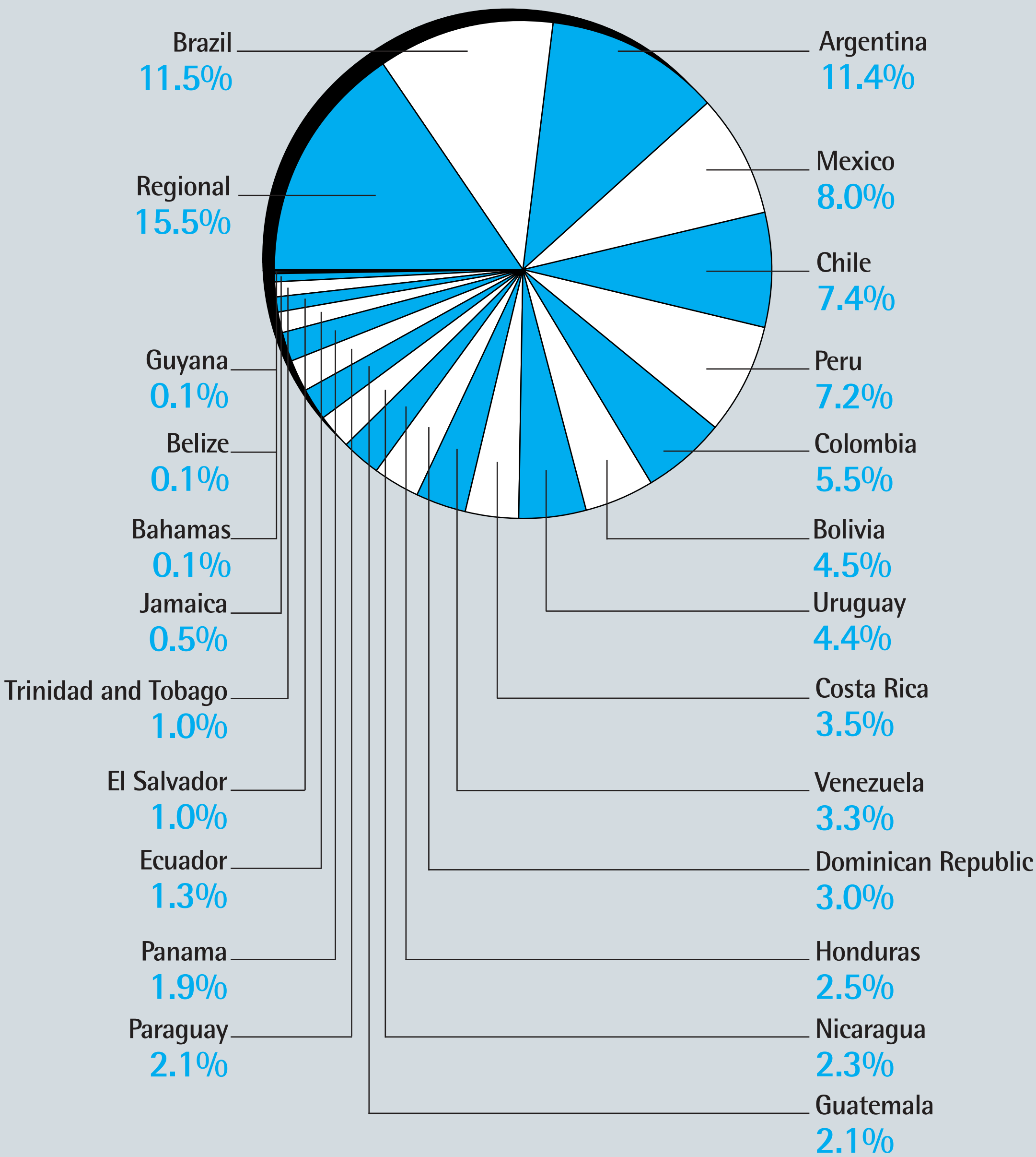
MEXICO

Loan: Up to $10 million
Total project cost: $21.5 million

Instituto Superior Autónomo del Occidente, A.C. – UNIVA offers education services in several Mexican cities in the states of Michoacán, Jalisco, and Sinaloa. UNIVA has its own campus only in Guadalajara; in the other cities it uses rented houses. UNIVA seeks to serve the middle and working classes, and its schedules and low cost are tailored to those who combine work with study.

Aggregate net approved projects by country

As of 12/31/2002



The project consists of building and equipping the first phase of three new campuses, as well as the construction of a library and a parking lot at the Guadalajara campus.

This is the first IIC loan to the education sector in Mexico. An economic sector that is key to development, education builds a qualified labor force that adds value to production in a world in which innovation and knowledge command an ever-higher premium. With this loan, the IIC will provide long-term funding on appropriate terms to a sector in which private banking in the region has historically shown little interest. In addition, the project will create some 480 direct jobs in central Mexico and 25 indirect jobs.

NICARAGUA

IIC Loan: $1 million
LAAD Loan: $1 million

Industria Gemina, S.A.*, is a small Nicaraguan company with bakeries in Nicaragua and Honduras that focuses its product line on the low-income market segment. The company has started to export wheat flour to Costa Rica and Honduras and has plans to expand to El Salvador. The $2 million in funding it will receive under the IIC/LAAD agency line agreement will help it reduce interest costs and improve its liquidity position, as well as create twenty-five permanent jobs. The total cost of the Gemina project is $2 million.*

Gemina's processing system has been designed to protect the environment, and the wheat and rice by-products are sold to animal feed manufacturers and chicken farmers.

PANAMA

Loan: Up to $3 million
Total project cost: $9.4 million

Térmica del Noreste, S.A. (Ternor) will purchase and modernize thirteen small power plants located in northeastern Panama. Ternor sells energy to Elektra, a private distribution company with a concession to provide electricity to the area.

Having purchased the power plants, Ternor will replace the existing diesel equipment with heavy fuel oil (bunker) equipment in the largest plant, which accounts for nearly 45 percent of the total power generated by the company. This change in technology will allow for better fuel efficiency, lower fuel and maintenance costs, and a more reliable system. The project also involves the relocation of a power plant from an urban area into an industrial area.

The IIC loan will enable Térmica del Noreste to create more than eighty permanent jobs.

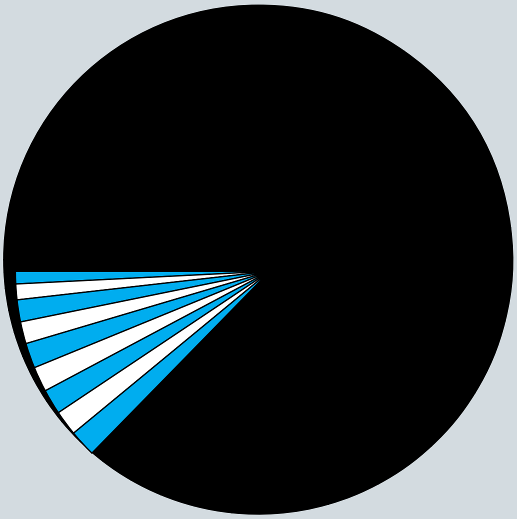
PERU

Loan: $2 million
Maximum subloan: $500,000

Banco Interamericano de Finanzas (BIF) will use the proceeds from the IIC loan to provide medium- and long-term financing to small and medium-size enterprises in Peru seeking to modernize and/or expand their operations. BIF intends to identify small and medium-size enterprises operating in the retail, communications, manufacturing, service, and transportation sectors. Small and medium-size export companies, which are a significant generator of foreign exchange, will be given priority for extending loans.

Breakdown, by sectors, of aggregate net financing approved

As of 12/31/2002



Loan: $10 million
Total project cost: $26.9 million

Quimpac S.A., a manufacturer of chemicals, salt, and paper, is an important producer of chlorine and caustic soda in South America and the leading source of paper rolls and salt in Peru. The company will invest in infrastructure, machinery, and equipment to replace outdated assets, reduce production costs, improve environmental conditions, and make better use of its installed capacity.

With the help of the IIC loan, Quimpac will increase production capacity and improve product quality. The new investments will also allow the company to introduce new chlorine by-products in the Latin American chemical markets, as well as increase its export sales. Forty-five percent of the planned investments are earmarked for environmental improvements that will increase safety and reduce waste.

The project will help create approximately 40 direct jobs and 200 temporary indirect jobs and will, to a large extent, utilize local raw materials and services.

Loan: $8.5 million
Total project cost: $16.3 million

Sindicato Energético S.A. (SINERSA), a hydroelectric power generator, will build and operate the 15.4 megawatt Poechos hydroelectric plant. The energy produced by the Poechos plant will be sold to Electronoroeste S.A. (ENOSA), which holds the concession for distributing power in northwestern Peru.

Almost 50 percent of the inhabitants of ENOSA's service area lack electric service. There are plans to build three small power distribution systems that will be fed directly by Poechos. These small systems are expected to benefit more than 20,000 people in the area.

The $8.5 million facility arranged by the IIC is structured as an A and B loan. The IIC will provide the $6 million A loan, and Corporación Interamericana para el Financiamiento de Infraestructura (a financial institution supported by the IIC) will provide the $2.5 million B loan.

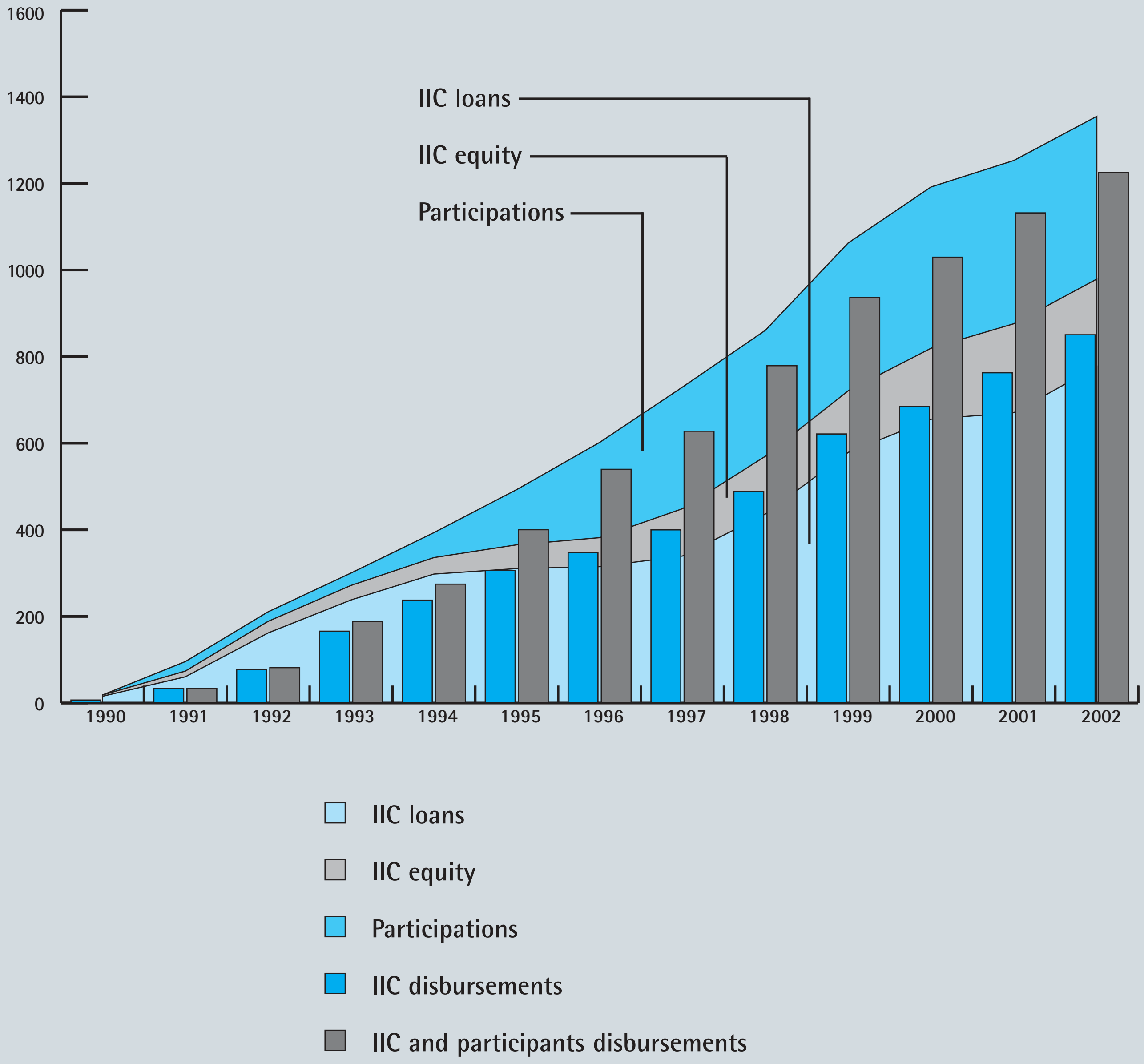
Loan: $5 million
Total project cost: $18.7 million

Tecnofil S.A. will expand and modernize its copper product manufacturing facilities. More efficient production lines will enable the company to expand its sales volume and increase yearly exports by some $14 million. Tecnofil already has ISO 9000 certification for all of its processes and products and expects to receive ISO 14000 environmental certification in early 2003.

The IIC loan will also help Tecnofil preserve a viable business that employs more than 250 people and uses a large amount of local resources. Tecnofil contributes close to $2.5 million per year in salaries and benefits. Moreover, as a result of the project, the company's utilization of local raw materials will increase from some $21.5 million per year to $28.5 million per year.

Cumulative committed portfolio

As of 12/31/2002 (US$ millions)



Loan: $5 million
Total project cost: $10.1 million

VENEZUELA

Vasos Venezolanos, C.A., and **Inversiones Selva S.A.** manufacture disposable thermoformed plastic and paper products, including straws, cups, and hospital admission kits.

The IIC loan will help preserve the companies' economic and financial viability by enabling them to refinance short-term debt, finance permanent working capital to sustain growing sales, expand warehouse capacity, and centralize a large part of their administrative operations. The loan will also provide long-term financing to these companies, which seek to increase their share of the export market, and help preserve more than one thousand jobs.

Estimated economic impact of approved active projects ($ in millions)[1/]

As of 31 December 2002

	Number of Active Projects	Number of Countries	Project Cost	IIC PARTICIPATION Loan	IIC PARTICIPATION Equity	IIC PARTICIPATION Total	Annual Foreign Exchange Generation[2/]	Annual Value Added	Jobs Created
DIRECT FINANCE TRANSACTIONS	63	20	1,121	332.7	11.2	343.9	756.0	691	46,191
FINANCIAL INTERMEDIARIES AND INVESTMENT FUNDS	70	16	3,552	243.0	168.1	411.03	1,495	3,758	161,888
TOTAL	**133**	**21**	**4,673**	**575.7**	**179.2**	**754.9**	**2,250.9**	**4,449**	**208,079**

1/ Approvals net of dropped or canceled projects.
2/ Includes estimated value of exports and import substitution.

Operations approved in 2002*

(In US$ millions except job creation)

Country	Project Name	Sector	Gross Loan Approved	Gross Equity Approved	Gross Loan & Equity	Estimated Project Cost	Annual Value Added	Annual Foreign Exchange	Job Creation
Belize	FRESH CATCH BELIZE LIMITED	Aquaculture & Fisheries	1.0	0.0	1.0	4.2	15.0	17.2	120
Brazil	ALE	Non-Financial Services	6.0	0.0	6.0	33.7	3.0		2,000
Chile	SUBSOLE	Agriculture & Agribusiness	7.0	0.0	7.0	18.4	21.0	21.2	4,590
Colombia	BANCO DE BOGOTÁ	Financial Services	10.0	0.0	10.0	25.0			
Dominican Republic	ABCO	Others	5.0	0.0	5.0	17.9	15.0	30.0	95
Ecuador	AQUAMAR	Aquaculture & Fisheries	5.0	0.0	5.0	11.8	5.0	32.0	1,591
El Salvador	FUNDACIÓN EMPRESARIAL PARA EL DESARROLLO	Education	4.3	0.0	4.3	8.9	4.3		35
Honduras	GRANJAS MARINAS LARVICULTURA	Agriculture & Agribusiness	1.5	0.0	1.5	2.5			0
Mexico	UNIVERSIDAD DEL VALLE DE ATEMAJAC	Education	10.0	0.0	10.0	21.5	30.0		505
Nicaragua	GEMINA	Agriculture & Agribusiness	1.0	0.0	1.0	2.0	28.0	39.5	25
Panama	TÉRMICA DEL NORESTE	Utilities & Infrastructure	3.0	0.0	3.0	9.4	5.0		81
Peru	QUIMPAC	Chemicals & Plastics	10.0	0.0	10.0	26.9	12.0	9.0	240
Peru	SINERSA	Utilities & Infrastructure	8.5	0.0	8.5	16.3	4.0		112
Peru	TECNOFIL	General Manufacturing	5.0	0.0	5.0	18.7	16.0	12.5	
Peru	BANCO INTERAMERICANO DE FINANZAS	Financial Services	2.0	0.0	2.0	5.0			
Regional A/B/C & D	SULEASING INTERNACIONAL	Financial Services	10.0	0.0	10.0	25.0			
Regional C/D Only	PROBA, L.P.	Investment Funds	0.0	6.0	6.0	60.0			
Regional C/D Only	AUREOS	Investment Funds	0.0	3.0	3.0				
Regional C/D Only	SMALL LOAN PROGRAM	Small Loan Program	20.0	0.0	20.0				
Venezuela	VASOS VENEZOLANOS, C.A.	Chemicals & Plastics	5.0	0.0	5.0	10.1	10.0	63.4	
	20		**114.3**	**9.0**	**123.3**	**317.3**	**168.3**	**224.8**	**9,394**

*Includes operations under agency lines.

Transactions through investment funds in 2002

The IIC channels its equity capital primarily through private equity funds in which it is a partner. The objectives of IIC's private equity fund program are

- to maximize value added to small and medium-size companies in the region by working through experienced, hands-on fund managers
- to promote the flow of long-term capital to the region and the private equity asset class to other institutional investors
- to minimize its own portfolio risk through diversification

Since1989, the IIC has approved forty-one investments in equity funds for a total of $215 million. These funds have an aggregate capitalization of $2.2 billion. The IIC has disbursed a total of $98 million to 171 companies in 19 countries in the region through investment funds.

There are currently twenty-three active funds in the IIC's portfolio, with commitments totaling $141 million. Set forth below are summaries of the projects that received IIC funding in 2002 through the following investment funds: Advent Latin America, Baring Private Equity Fund, Caribbean Investment Fund, Communications Equity Partner, Compass Capital Fund, Latin Health Care, Multinational Investment Fund, and Scudder Latin America Power II.

Amount invested by the fund: $400,000
IIC participation in the investment: $38,000

A Jamaican brewery with an extensive manufacturing and distribution network in Jamaica. The transaction is the first installment of a major investment in the firm to support its growth and expansion.

Amount invested by the fund: $685,000
IIC participation in the investment: $15,894

A wholesale distributor of specialty teas in the Bahamas for the export market, particularly the United States. The transaction will strengthen the brand name of this company seeking to gain market share.

Amount invested by the fund: $1.21 million
IIC participation in the investment: $18,699

A Jamaican theme restaurant chain seeking to build up its brand name in the restaurant, take-out, catering, and frozen dinner segments and establish several outlets in the Caribbean.

Amount invested by the fund: $1.30 million
IIC participation in the investment: $161,554

A market leader in the document storage market in Peru associated with a joint venture transaction for Latin America.

Amount invested by the fund: $2.53 million
IIC participation in the investment: $400,000

A company that has concession rights to manage commercial and office space in several international airports in Mexico. The company also provides airport services, such as terminal-to-plane transportation, and holds a small stake in a firm that operates restaurants at several airports.

Amount invested by the fund: $2.96 million
IIC participation in the investment: $560,000

A telecommunications company in Mexico that creates, develops, maintains, and operates the infrastructure to provide interconnection, service, and public link telecommunication facilities in areas such as telephony, data transmission, cable television, and value-added services.

Approvals, commitments, and disbursements*

(As of December 31, 2002 – US$ millions)

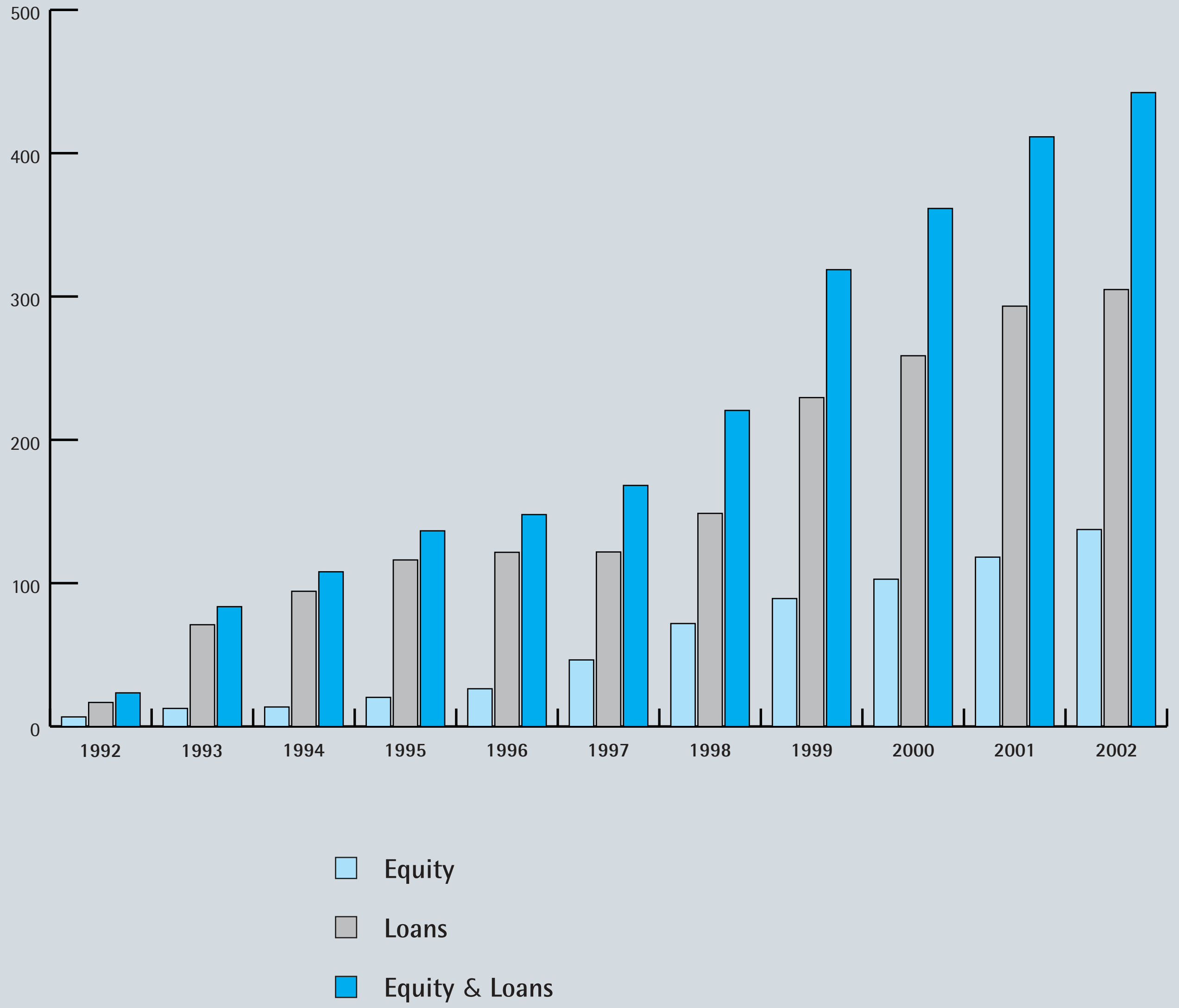
		Gross Approvals			Net Commitments			Disbursements		
Country	Number of Projects	Loan	Equity	Loan & Equity	Loan	Equity	Loan & Equity	Loan	Equity	Loan & Equity
Argentina	27	143.7	11.0	154.7	111.0	8.8	119.8	111.0	8.8	119.8
Bahamas	2	6.0	0.0	6.0	1.0	0.0	1.0	1.0	0.0	1.0
Barbados	1	0.0	4.0	4.0	0.0	0.0	0.0	0.0	0.0	0.0
Belize	1	1.0	0.0	1.0	1.0	0.0	1.0	1.0	0.0	1.0
Bolivia	12	52.6	1.9	54.5	46.3	1.3	47.6	46.3	1.3	47.6
Brazil	27	147.3	18.5	165.8	107.7	13.0	120.7	84.1	13.0	97.1
Chile	16	60.3	30.3	90.7	44.3	24.1	68.5	40.8	21.2	62.0
Colombia	15	73.2	12.9	86.0	38.0	9.5	47.5	38.0	9.5	47.5
Costa Rica	9	43.7	1.5	45.2	36.0	0.5	36.5	36.0	0.5	36.5
Dominican Republic	9	55.6	0.0	55.6	26.9	0.0	26.9	26.9	0.0	26.9
Ecuador	10	36.3	2.5	38.8	12.3	1.8	14.1	12.3	1.8	14.1
El Salvador	4	8.4	4.5	12.9	4.0	2.0	6.0	4.0	2.0	6.0
Guatemala	8	46.1	0.5	46.6	22.1	0.0	22.1	18.9	0.0	18.9
Guyana	2	3.3	0.0	3.3	0.8	0.0	0.8	0.8	0.0	0.8
Haiti	1	1.0	0.0	1.0	0.0	0.0	0.0	0.0	0.0	0.0
Honduras	11	52.4	1.0	53.4	25.4	0.0	25.4	24.4	0.0	24.4
Jamaica	6	19.3	1.5	20.8	5.6	0.0	5.6	5.6	0.0	5.6
Mexico	25	97.0	45.3	142.2	56.8	27.3	84.1	42.9	19.3	62.3
Nicaragua	9	29.8	1.4	31.2	23.0	0.9	23.9	22.0	0.9	22.9
Panama	5	20.0	0.0	20.0	20.0	0.0	20.0	19.4	0.0	19.4
Paraguay	6	25.6	0.0	25.6	21.9	0.0	21.9	18.3	0.0	18.3
Peru	21	116.0	10.8	126.8	64.3	4.5	68.8	51.2	4.5	55.7
Regional	30	76.2	153.0	229.2	25.0	101.5	126.5	8.1	79.9	88.1
Trinidad & Tobago	4	17.5	2.8	20.3	9.6	0.6	10.2	9.6	0.6	10.2
Uruguay	12	55.1	6.2	61.3	40.0	6.0	46.1	31.0	6.0	37.1
Venezuela	11	56.8	4.7	61.5	34.5	0.0	34.5	27.0	0.0	27.0
	284	**$1,244.0**	**$314.3**	**$1,558.3**	**$777.6**	**$201.9**	**$979.5**	**$680.7**	**$169.5**	**$850.1**

* Includes operations under agency lines.

Amount invested by the fund: $3.42 million IIC participation in the investment: $208,009	A company that manufactures, packages, and distributes branded frozen and refrigerated meat, poultry, and seafood products in Mexico. The company distributes most of its products directly to Mexico's main supermarket chains nationwide through its own sales force and distribution infrastructure.
Amount invested by the fund: $3.52 million IIC participation in the investment: $521,923	A supplier of liquefied petroleum gas and industrial gas in Jamaica, through a joint venture distributor of household gas in Trinidad and Tobago. The company sells gas through both company-owned and franchised filling plants located throughout Jamaica. It also has an extensive dealership network throughout the island.
Amount invested by the fund: $3.65 million IIC participation in the investment: $37,375	A manufacturer of powdered instant coffee and other breakfast products in Jamaica. The fund expects its investment to improve distribution channels and strengthen brand recognition, product quality, and presentation enough to launch a Jamaican-blend product for the export market.
Amount invested by the fund: $3.65 million IIC participation in the investment: $682,501	A holding company in Trinidad and Tobago that will have stakes in four Caribbean countries in the building products and aluminum extrusion industries.
Amount invested by the fund: $4.01 million IIC participation in the investment: $100,000	A local exchange carrier providing telecommunications infrastructure and services, including voice and Internet links, to tenants of a commercial building in Brazil.
Amount invested by the fund: $5 million IIC participation in the investment: $934,933	Part of a consortium that includes senior management of the firm, to participate in a management buyout of a controlling interest in an all-inclusive hotel chain in Barbados.
Amount invested by the fund: $5.36 million IIC participation in the investment: $84,878	A company in Peru that seeks to build a South American business storage network to provide services in the areas of business and vital record maintenance; filing, retrieval, and backup rotation; and complementary services such as consulting and imaging.
Amount invested by the fund: $11.1 million IIC participation in the investment: $100,000	A bottling company in Mexico for an international brand as well as regional soft drinks. The company owns four plants.
Amount invested by the fund: $11.2 million IIC participation in the investment: $729,732	A greenfield thermal power plant under construction that will supply electricity to a state in northeastern Brazil.
Amount invested by the fund: $24 million IIC participation in the investment: $186,641	A group of independent power generation facilities in Mexico with total capacity of 72 megawatts. The investment started in 2001 as a greenfield project. Commercial operation is expected for 2003.

Disbursed funding through investment funds and financial intermediaries

(US$ millions)



Subloans made by local financial intermediaries in 2002

Local financial intermediaries drawing on loans from the IIC can make smaller loans to smaller companies than the IIC can make directly. Such lending has a significant multiplier effect because the borrowing institutions are required to reinvest subloan proceeds as they are paid off.

Since 1989, the IIC has approved eighty-two loans to local financial intermediaries for a total of $506 million. These financial intermediaries have in turn made subloans for a total of $633 million to more than 3,400 small and medium-size companies in Latin America and the Caribbean.

Summarized below are the projects that received direct or indirect IIC funding through financial intermediaries in 2002.

Total subloans in 2002: twenty-two, for $1.77 million

América Leasing in Peru received a $5 million loan in 2001. The loan proceeds are being used to provide financing to small and medium-size companies via medium- and long-term finance leases for modernization and/or expansion projects.

Total subloans in 2002: seven, for $2.24 million

Banco Económico in Bolivia received a $5 million loan from the IIC in 1998. It on-lends the proceeds to small and medium-size productive enterprises in the agribusiness, manufacturing, and industrial sectors. Banco Económico also provides short-term working capital loans and trade finance credits.

Total subloans in 2002: two, for $426,000

Banco Improsa S.A. in Costa Rica provides international trade-related services. It is using a $6 million loan received from the IIC in 2000 to meet the demand for dollar-denominated long-term loans to small and medium-size companies in Costa Rica.

Total subloans in 2002: three, for $889,938

Banco Intercontinental Leasing is providing lease financing in the Dominican Republic, both in local currency and in U.S. dollars. The bank received a $3 million loan from the IIC in 1996.

Total subloans in 2002: three, for $1.63 million

Banco Interfin in Costa Rica is using a $6 million loan received from the IIC in 1998 to provide term financing to small and medium-size companies in Costa Rica, chiefly exporters of nontraditional goods. It is also leasing commercial and industrial equipment and providing investment banking services.

Total subloans in 2002: eight, for $4.26 million

Banco Popular Dominicano C.A. received a $10 million A loan and a $19 million B loan from the IIC in 2000. The funds are being used to provide financing to small and medium-size Dominican companies, mainly exporters.

Total subloans in 2002: one, for $335,000

Banco Uno (formerly Banexpo) in Nicaragua received a $5 million loan from the IIC in 1999 for on-lending to small and medium-size companies.

Total subloans in 2002: 384, for $6.4 million

Delta Leasing Habitacional is leasing low- to middle-income housing in Chile using funds from a $7 million loan from the IIC approved in 2000. Another source of funding is the securitization of the portfolio of housing loans and the sale of mortgage-backed securities.

Countries of origin and aggregate procurement, 1989–2002
(US$000)

Argentina	289,148
Austria	358
Bahamas	2,612
Barbados	3,000
Bolivia	10,252
Brazil	167,220
Chile	133,945
Colombia	24,493
Costa Rica	69,458
Denmark	8,038
Dominican Republic	30,043
Ecuador	21,037
El Salvador	14,697
Finland	2,240
France	12,717
Germany	71,165
Guatemala	49,241
Guyana	600
Honduras	56,408
Israel	11,467
Italy	38,803
Jamaica	4,940
Japan	16,142
Mexico	96,844
Netherlands	35,084
Nicaragua	23,043
Norway	7,521
Panama	13,652
Paraguay	5,297
Peru	67,875
Regional	14,530
Spain	18,631
Sweden	677
Switzerland	11,658
Trinidad and Tobago	1,000
United States	369,974
Uruguay	63,371
Venezuela	37,281
Grand Total	**1,804,460**

Total subloans in 2002:
one, for $300,000

Banco Financiera Centroamericana, S.A., in Honduras, is using a $4 million loan received from the IIC in 2000 to provide financing for small and medium-size companies that operate chiefly in the industrial, manufacturing, construction, and agribusiness sectors.

Total subloans in 2002:
twenty-four, for $3.3 million

PLG Capital Partners (formerly El Camino Resources de América Latina), a regional fund covering Costa Rica, Guatemala, El Salvador, and other Central American countries, is using a $15 million loan received from the IIC in 1996 to provide bridge financing for loans that are in turn used to purchase equipment and enter into operational leasing agreements with middle-market companies.

Corporate governance in Latin America and the Caribbean: a bigger challenge

Professor Florencio López-de-Silanes
Yale University and National Bureau of Economic Research

Why do we observe such large differences in the size, breadth, and valuation of capital markets? Why, for example, are equity markets so much larger in South Africa than in Mexico or Peru? Why did many companies go public in India and Hong Kong in 1995, while no company went public in Brazil or Uruguay or Venezuela in the same year? Why do countries like New Zealand have large credit markets while Argentina and Colombia do not have them?

In a simple Modigliani-Miller framework (Modigliani and Miller, 1958) the size of capital markets is determined only by the cash flows that accrue to investors. Therefore, roughly speaking, the size of capital markets should be proportional to gross national product (GNP). To explain the large discrepancies in the size of financial markets across countries with similar GNP, we need to recognize that securities are more than the cash flows they represent, because they entitle investors to exercise certain rights. Shares entitle investors not only to dividend payments, but also to exercise control over management through the voting process. Similarly, debt entitles creditors not only to receive interest payments, but also to regain their collateral in the event of bankruptcy of the firm.

The separation between ownership and control can have a large effect on the size of capital markets once we depart from the Modigliani-Miller assumptions and allow for the existence of agency costs. To take an extreme view, outside equity would have no value if shareholders did not have control rights to force managers to pay out dividends. In the same vein, creditors would be unwilling to lend money at any interest rate if their control rights did not allow them to punish debtors who default on their financial obligations. Both financiers and management would benefit from the elimination of the agency conflict if they could write a complete contract that specified what the manager should do with the funds and how he would give them back to investors in all states of the world. Of course, a complete contract cannot be implemented in practice, making it necessary for management to have a level of discretion (Grossman and Hart, 1986). Management discretion, although a cost-effective way of dealing with the separation of ownership and control, can unfortunately be used to expropriate financiers through outright expropriation, transfer pricing, or asset-stripping.

In the framework of expropriation, the law and its enforcement are key ingredients in explaining why some countries have much larger capital markets than others, since it is apparent that countries differ enormously in the extent to which they afford legal protection to investors. Not only do shareholders in the average Latin American or Caribbean country, for example, have a very different bundle of rights from one in the United Kingdom or the United States, but their recourse to redress is likely to be significantly weaker.

The legal theory predicts larger capital markets in countries where agency costs are reined in by the law and the institutions built to support their enforcement. La Porta et al. (1998) systematically assess the rights of investors as well as the quality of their enforcement for forty-nine countries. La Porta et al. (1997, 1998, 1999) relate legal institutions to the size and breadth of external capital markets as well as to the concentration of corporate ownership around the world.

Graphs 1 and 2, drawn from data in La Porta et al. (1998, 2002), show that better investor protection is linked to deeper markets, measured as the value of all firms in the stock exchange as a proportion of the economy (vertical axis). Because investor rights are determined not only by laws, the horizontal axis of graph 1 takes into account a measure of the quality of the legal enforcement. Graph 2 also shows that accounting standards across nations are a powerful predictor of the size of capital markets. This evidence corroborates the importance of disclosure and transparency and gets at the root of the recent wave of corporate governance scandals in the United States and elsewhere.

The ultimate problem of poor corporate governance is that firms actually do suffer. As the graphs show, laws and their enforcement matter. This means that countries that offer entrepreneurs better terms of external finance would have both higher-valued and broader capital markets. On the other hand, firms in nations with poor investor protections have less access to capital, and when they do its cost is higher, because they show lower valuations than similar firms in countries with good protection.

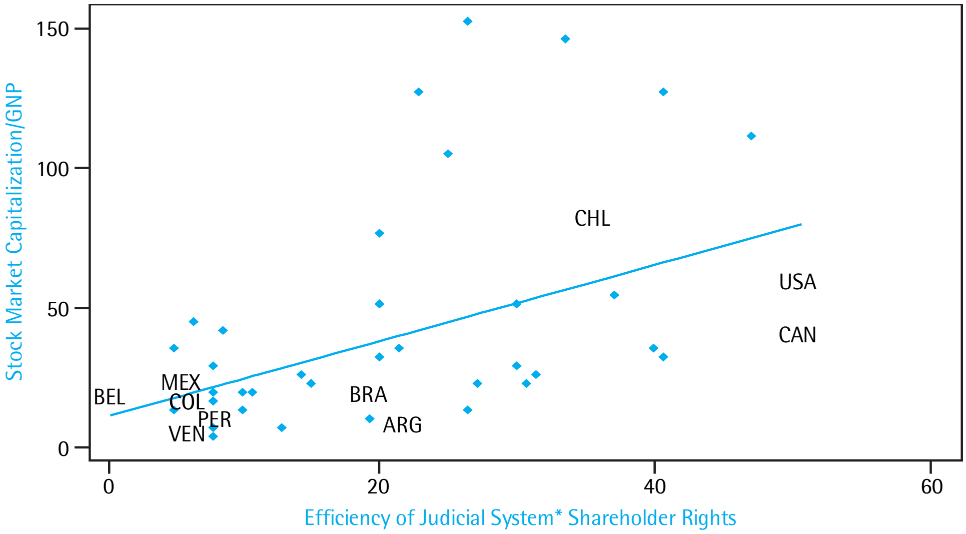
As the graphs clearly show, Latin American and Caribbean countries, in general, offer investors a rather unattractive legal environment. Investor rights and the quality of enforcement lag behind most of the rest of the world. As a result, capital markets are exceedingly small and narrow.

It is clear that improving corporate governance should be at the top of the policy agenda in Latin America and the Caribbean. This reaction should be reinforced by the current wave of corporate governance reforms that are occurring in the United States as a result of the now famous scandals of Enron and WorldCom. The effect of these scandals will be strongly felt in Latin America and the Caribbean. The regulatory reaction in the United States has lifted the bar for corporate governance and disclosure standards, and those Latin American and Caribbean countries lagging behind now face a bigger challenge.

The immediate reaction to the evidence surveyed in these pages is to call for wholesale legal reform. Clearly, minority shareholders would benefit from the existence of a mechanism to redress expropriation, and there is plenty of room to strengthen voting rights and to enhance disclosure requirements. Similar arguments can be made for creditor rights.

However, to the extent that improving the efficiency of the judicial system

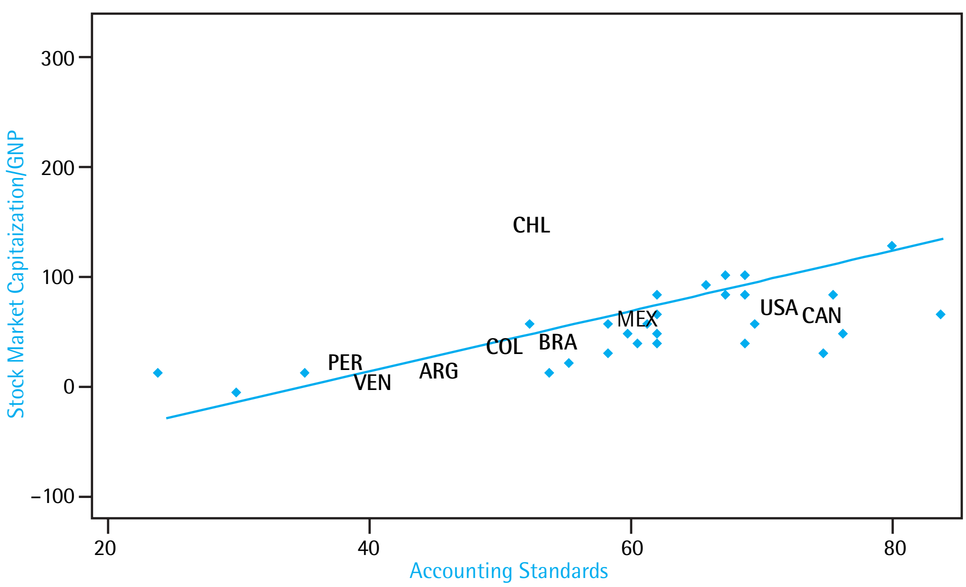
Graph 1.
Better investor protection → deeper financial markets



A measure of effective investor protection. It is computed as the efficiency of the judicial system index, which is an assessment of the efficiency and integrity of the legal environment as it affects businesses (scale from 0 to 10) times the shareholders rights index, which measures the shareholders rights as stated in the company law of each country.

Stock market capitalization/GNP. The value of all companies that issue stock, as a percentage of gross national product in each country.

Graph 2.
Better accounting standards → deeper financial markets



Index created by examining and rating companies' 1990 annual reports on their inclusion or omission of ninety items. These items fall into seven categories (general information, income statements, balance sheets, funds flow statement, accounting standards, stock data, and special items). A minimum of three companies in each country were studied. The companies represent a cross-section of various industry groups, where industrial companies represent 70 percent while financial companies represent the remaining 30 percent.

and asserting the rule of law are slow processes, it is important to incorporate those constraints into policy design. For example, it may be particularly valuable to adopt an oppressed minority mechanism, perhaps similar to that of Chile, that minimizes the involvement of the courts even if its more mechanical nature results in less fair outcomes. Similarly, mandating enhanced disclosure requirements may not be sufficient in countries with weak legal institutions. In such instances it may be desirable, for example, to allow institutional investors to invest only in companies that meet minimum corporate governance standards as determined by independent best-practice commissions.

Finally, in the area of creditor rights, one may want to emphasize bankruptcy procedures that minimize the involvement of courts. The United Kingdom's administration procedure is an example of bankruptcy procedure that puts most of the discretion on the hands of commercial banks rather than on courts. Along the same lines, another departure from current practice would introduce market forces in the bankruptcy process by auctioning off bankrupt firms in much the same way that state-owned enterprises are currently privatized (Hart et al., 1997).

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Report of independent accountants

Board of Governors,
Inter-American Investment Corporation

In our opinion, the accompanying balance sheets and the related statements of income and retained earnings and of cash flows present fairly, in all material respects, the financial position of the Inter-American Investment Corporation at December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Corporation's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Washington, D.C.

7 February 2003

Balance sheets

As of December 31, 2002 and 2001 (US$ thousands)

	2002	2001
ASSETS		
Cash	$ 1,359	$ 3,576
Marketable Securities	76,207	50,436
Investments		
Loan Investments	268,827	275,417
Less Allowance for Losses	(45,702)	(30,421)
	223,125	244,996
Equity Investments	114,090	101,072
Less Allowance for Losses	(41,146)	(27,032)
	72,944	74,040
Mortgage-backed Securities	4,816	4,338
Total Investments	300,885	323,374
Receivables and Other Assets	6,788	4,062
Total Assets	**$ 385,239**	**$ 381,448**
LIABILITIES AND EQUITY		
Accounts Payable and Other Liabilities	$ 17,868	$ 6,319
Interest and Commitment Fees Payable	482	24
Borrowings	85,000	105,000
Total Liabilities	**$ 103,350**	**$ 111,343**
Capital		
Authorized: 70,370 shares (Par $10,000)		
Subscribed Shares	691,560	681,910
Less Subscriptions Receivable	(358,635)	(401,885)
	332,925	280,025
Accumulated Deficit	(51,036)	(9,920)
Total Liabilities and Equity	**$ 385,239**	**$ 381,448**

The accompanying notes are an integral part of these financial statements.

Statements of income and retained earnings

For the years ended December 31, 2002 and 2001 (US$ thousands)

	2002	2001
INCOME		
Marketable Securities	$ 1,706	$ 2,873
Loan Investments		
Interest	12,100	20,166
Commitment Fees	385	477
Front-End Fees	983	476
Other Loan Investment Income	619	251
	14,087	21,370
Equity Investments		
Gain on Sale of Equity Investments	539	2,081
Dividends	1,165	1,261
Other Equity Investment Income	472	80
	2,176	3,422
Mortgage-backed Securities		
Interest	614	207
Unrealized (Loss) Gain on mortgage-backed securities	(1,829)	515
	(1,215)	722
Advisory Service, Cofinancing and Other Income	2,110	3,138
	$ 18,864	**$ 31,525**
EXPENSES		
Administrative	16,012	14,103
Provision for Loan and Equity Investment Losses	44,480	25,511
Unrealized (Gain) Loss on Derivative	(2,524)	619
Borrowing	2,012	6,621
	59,980	**46,854**
NET LOSS	**(41,116)**	**(15,329)**
(ACCUMULATED DEFICIT) RETAINED EARNINGS AT BEGINNING OF YEAR	**(9,920)**	**5,409**
(ACCUMULATED DEFICIT) AT END OF YEAR	**$ (51,036)**	**$ (9,920)**

The accompanying notes are an integral part of these financial statements.

Statements of cash flows

For the years ended December 31, 2002 and 2001 (US$ thousands)

	2002	2001
CASH FLOWS FROM INVESTING ACTIVITIES		
Loan Disbursements	$ (64,555)	$ (58,208)
Equity Disbursements	(19,276)	(15,333)
Mortgage-backed Security Disbursements	(3,921)	(4,239)
Loan Repayments	55,667	46,688
Sales of Equity Investments	2,000	2,542
Return of Capital from Closed-end Investments	3,972	2,330
Mortgage-backed Security Repayments	1,614	417
Proceeds from Recovered Assets	679	416
Net cash used in investing activities	**$ (23,820)**	**$ (25,387)**
CASH FLOWS FROM FINANCING ACTIVITIES		
Drawdown of Borrowings	50,000	90,000
Repayment of Borrowings	(70,000)	(145,000)
Capital Subscriptions	52,900	56,150
Net cash provided by financing activities	**$ 32,900**	**$ 1,150**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Loss	(41,116)	(15,329)
Marketable Securities:		
Purchases	(1,571,758)	(2,562,370)
Sales, Maturities and Repayments	1,546,014	2,574,352
	(25,744)	11,982
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Provision for loan and equity investment losses	44,480	25,511
Change in receivables and other assets	(2,726)	3,043
Change in accounts payable and other liabilities	11,549	2,938
Change in interest and commitment fees payable	458	(1,493)
Unrealized loss (gain) on mortgage-backed securities	1,829	(515)
Unrealized gain on marketable securities	(27)	(106)
	55,563	29,378
Net cash (used in) provided by operating activities	(11,297)	26,031
Net (decrease) increase in cash	(2,217)	1,794
Cash at beginning of year	3,576	1,782
Cash at end of year	**$ 1,359**	**$ 3,576**
Supplemental disclosure:		
Interest paid during the year	1,377	$ 7,977

The accompanying notes are an integral part of these financial statements.

Notes to the financial statements

December 31, 2002 and 2001

Purpose

The Inter-American Investment Corporation (the Corporation), a multilateral organization, was established in 1986. The Corporation is a member of the Inter-American Development Bank Group (IDB Group), which also includes the Inter-American Development Bank (IDB) and the Multilateral Investment Fund (MIF). The Corporation began operations in 1989 with the mission to promote the economic development of its Latin American and Caribbean member countries by financing small and medium-size enterprises. The Corporation, together with private investors, accomplishes this mission by making loan and equity investments where sufficient private capital is not otherwise available on reasonable terms, mobilizing additional project funding from other investors and lenders through cofinancing or loan syndications, and providing financial and technical advisory services. The Corporation receives its share capital from its member countries, conducts its operations only in United States dollars, and limits operational activity to its twenty-six regional member countries.

Note A — Summary of significant accounting and related policies

The accounting and reporting policies of the Corporation conform with accounting principles generally accepted in the United States of America (US GAAP).

Financial statements presentation

Certain amounts in the prior year have been reclassified to conform to the current year's presentation.

Use of estimates

The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expense during the reporting period. Actual results could differ from these estimates. A significant degree of judgment has been used in the determination of the adequacy of the reserve against losses on loan and equity investments, the fair value of mortgage-backed securities, and all derivative instruments. There are inherent risks and uncertainties related to the Corporation's operations. The possibility exists that changing economic conditions could have an adverse effect on the financial position of the Corporation.

Marketable securities

As part of its overall portfolio management strategy, the Corporation invests in government and agency obligations, time deposits, and asset-backed securities according to the Corporation's credit risk and duration policies. Government and agency obligations include highly rated fixed rate bonds, notes, bills, and other obligations issued or unconditionally guaranteed by governments of countries or other official entities, including government agencies. The Corporation's marketable securities portfolio is classified as trading and is reported at market value with changes in fair value and realized gains and losses reported in income from marketable securities. Purchases are recorded as assets on the trade date, while interest and dividends on securities and amortization of premiums and accretion of discounts are reported in income from marketable securities.

Loan and equity investments

Loan and equity investments are committed when the loan or equity agreement is signed and are recorded as assets when disbursed. Loan investments are carried at the principal amounts outstanding, adjusted for allowance for losses. It is the Corporation's practice to obtain collateral security such as, but not limited to, mortgages and third-party guarantees. Equity investments without a readily determinable market value are initially carried at cost. This carrying amount,

Notes to the financial statements

December 31, 2002 and 2001

as described below, is periodically reviewed and adjusted for impairments. On occasion the Corporation enters into put option agreements in connection with equity investments.

The Corporation considers a loan impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the loan's contractual terms. The allowance for loan losses represents management's judgment of the present value of expected future cash flows discounted at the loan's effective interest rate.

Allowance for losses on loan and equity investments

The Corporation follows the policy of periodically reviewing the risk rating of all loan and equity investments and establishing an allowance for loss based on that review. Management's judgment is based on the risk ratings and performance of individual investments, the size and diversity of the Corporation's portfolio, economic conditions, and other factors considered significant by management. The calculation of the allowance for losses includes the use of estimates of collateral values and other potential sources of cash flow. The allowance for losses is established through periodic charges to income in the form of a provision for losses on investments. Investments written off, as well as any subsequent recoveries, are recorded through the allowance account. The allowance for losses is maintained at a level that, in management's judgment, is adequate to absorb estimated losses in the loan and equity portfolio and adequately reflects the risk of loss in the Corporation's portfolio.

Revenue recognition on loan and equity investments

Interest and all fees except front-end fees are recognized as income in the periods in which they are earned. Front-end fees and incremental direct costs associated with the origination of loan and equity investments are not amortized since the net is considered immaterial. The Corporation does not recognize income on loans where collectibility is in doubt or payments of interest or principal are past due more than 90 days. Under this past-due based nonaccrual policy, loans may be placed on nonaccrual status even when they may not meet the definition of impaired. Any interest accrued on a loan placed in nonaccrual status is reversed out of income and is thereafter recognized as income only when received and management has concluded that the borrower's ability to make periodic interest and principal payments has been demonstrated. Interest not previously recognized but capitalized as part of a debt restructuring is recorded as deferred income and credited to income only when the related principal is received.

Investment in mortgage-backed securities

Investments in mortgage-backed securities are classified as trading and are carried at fair value in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. The Corporation's investment in mortgage-backed securities is classified as trading and is reported at market value, with changes in fair value and unrealized gains and losses reported in unrealized income on mortgage-backed securities.

Risk management and derivative instruments

The Corporation enters into transactions involving various derivative instruments for risk management purposes. These derivatives are designed to minimize the Corporation's interest rate and foreign exchange risks in respect of certain investments. In accordance with SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, the Corporation marks these derivatives to market and records them as assets and/or liabilities at the balance sheet date, with unrealized gains and losses reflected in earnings.

Notes to the financial statements

December 31, 2002 and 2001

Fixed assets

The Corporation depreciates fixed assets on a straight-line basis over the estimated useful lives of the assets, which range from three to seven years. Costs associated with the development of computer software for internal use are capitalized and amortized over the useful life of the software.

Fair value of financial instruments

SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, requires entities to disclose information about the estimated fair value of their financial instruments, whether or not those values are recognized on the balance sheet.

For many of the Corporation's financial instruments it is not practicable to estimate the fair value, and therefore, in accordance with SFAS No. 107, additional disclosures pertinent to estimating the fair value, such as the carrying amount, interest rate, and maturity, are provided.

The following methods and assumptions were used by management in estimating the fair value of the Corporation's financial instruments:

Cash: The carrying amount reported in the balance sheet approximates fair value.

Marketable Securities: Fair values for marketable securities are based on quoted market prices. See Note B.

Loan Investments: The Corporation provides custom-tailored financing to small and medium-size enterprises operating in its developing member countries. There is no comparable secondary market for these types of loans. For the majority of loans and related commitments, management is of the opinion that due to the Corporation's unique position in its lending operations and the absence of an established secondary market, it is not practicable to estimate a fair value for the Corporation's lending portfolio at this time. See Note C.

Equity Investments: The Corporation purchases the capital stock of small and medium-size private sector enterprises in Latin America and the Caribbean. In most cases, market prices are not available and alternate valuation techniques are not practicable. See Note C.

Mortgage-Backed Securities: In the absence of quoted market prices and an active market, the fair value of mortgage-backed securities is based on significant estimates made by Management. See Note C.

Borrowings: The carrying amount reported in the balance sheet for borrowings approximates fair value. See Note F.

Accounting and financial reporting developments

During the year ended December 31, 2002, the Financial Accounting Standards Board (FASB) issued several new accounting standards: SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets;* SFAS No. 145, *Recission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13,* and *Technical Corrections;* SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities;* and SFAS No. 147, *Acquisitions of Certain Financial Institutions—an amendment of FASB Statements No. 74 and 144 and FASB Interpretation No. 9.* None of these accounting standards are expected to have a material impact on the Corporation.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.* FIN 45 requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee. The disclosure provisions of FIN 45 are effective for financial statements of interim or annual periods that end after December 15, 2002. The provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002, irrespective of a guarantor's year-end. The interpretation's

Notes to the financial statements

December 31, 2002 and 2001

expanded disclosures did not have a material impact on the Corporation's financial position or results of operations. The Corporation does not believe that the adoption of the recognition and initial measurement requirements of this interpretation will have any impact on its financial position or results of operations.

Note B – Marketable securities

Components of marketable securities for the years ended December 31, 2002 and 2001 consist of (US$ thousands):

	2002	2001
Government and agency obligations	$ 30,634	$ 20,679
Asset-backed securities	22,265	22,673
Corporate securities	23,308	7,084
	$ 76,207	**$ 50,436**

Components of net income from marketable securities for the years ended December 31, 2002 and 2001 consist of (US$ thousands):

	2002	2001
Interest income	$ 1,592	$ 2,922
Unrealized gain	27	106
Realized gain (loss)	87	(155)
	$ 1,706	**$ 2,873**

Notes to the financial statements

December 31, 2002 and 2001

Note C – Loan, equity, and mortgage-backed security investments

The Corporation monitors the outstanding loan and equity portfolios for geographic concentration of credit risk. The Corporation's single largest exposure is designated as Regional, which consists primarily of multicountry private equity investment funds. At December 31, 2002, individual countries with the largest aggregate credit exposure to the Corporation included Argentina, Chile, and Brazil.

The distribution of the outstanding portfolio by country and by sectors as of December 31, 2002 and 2001 is as follows (US$ thousands):

	2002			2001		
	Loan	Equity	Total	Loan	Equity	Total
Regional	$ 4,276	$ 70,131	$ 74,408	$ 3,170	$ 56,240	$ 59,410
Argentina	39,931	2,000	41,931	55,121	2,000	57,121
Chile	21,178	15,810	36,988	12,375	12,974	25,349
Brazil	24,566	9,163	33,730	21,355	9,285	30,640
Mexico	17,338	12,371	29,709	12,529	13,100	25,629
Costa Rica	17,530	–	17,530	22,168	–	22,168
Venezuela	16,068	–	16,068	9,833	–	9,833
Peru	15,946	–	15,946	17,029	–	17,029
Dominican Republic	15,414	–	15,414	17,072	–	17,072
Nicaragua	14,354	400	14,754	12,762	400	13,162
Colombia	12,000	2,571	14,571	4,000	3,429	7,429
Honduras	14,252	–	14,252	15,932	–	15,932
Bolivia	13,203	–	13,203	26,200	–	26,200
Panama	10,229	–	10,229	9,314	–	9,314
Guatemala	9,253	–	9,253	15,146	–	15,146
Paraguay	7,863	–	7,863	11,111	–	11,111
Uruguay	5,779	1,046	6,825	5,172	1,046	6,218
Ecuador	5,760	–	5,760	1,252	–	1,252
Trinidad & Tobago	2,646	598	3,244	3,476	598	4,074
Belize	1,000	–	1,000	–	–	–
Bahamas	240	–	240	400	–	400
El Salvador	–	–	–	–	2,000	2,000
TOTAL	**$ 268,827**	**$ 114,090**	**$ 382,917**	**$ 275,417**	**$ 101,072**	**$ 376,489**

	Loan	Equity	Total	Loan	Equity	Total
Financial Services	$ 111,295	$ 21,229	$ 132,524	$ 143,381	$ 10,486	$ 153,867
Investment Funds	–	86,711	86,711	–	82,436	82,436
Aquaculture & Fisheries	20,195	4,150	24,345	3,637	4,150	7,787
Agriculture & Agribusiness	19,390	2,000	21,390	13,634	2,000	15,634
Utilities & Infrastructure	19,535	–	19,535	18,471	–	18,471
Transportation & Warehousing	14,952	–	14,952	14,610	–	14,610
Chemicals & Plastics	13,162	–	13,162	7,167	–	7,167
Tourism & Hotels	11,197	–	11,197	16,774	–	16,774
General Manufacturing	10,501	–	10,501	13,112	–	13,112
Wood, Pulp & Paper	10,167	–	10,167	2,000	–	2,000
Food, Bottling & Beverages	9,181	–	9,181	11,619	2,000	13,619
Industrial Processing Zones	7,557	–	7,557	8,667	–	8,667
Non–Financial Services	7,390	–	7,390	10,427	–	10,427
Health	5,140	–	5,140	880	–	880
Textiles, Apparel & Leather	4,522	–	4,522	5,913	–	5,913
Tech, Comm & New Economy	3,143	–	3,143	4,000	–	4,000
Education	1,000	–	1,000	–	–	–
Capital Markets	499	–	499	499	–	499
Oil & Mining	–	–	–	626	–	626
TOTAL	**$ 268,827**	**$ 114,090**	**$ 382,917**	**$ 275,417**	**$ 101,072**	**$ 376,489**

Notes to the financial statements

December 31, 2002 and 2001

Loan and equity investments approved by the Board of Executive Directors to be held by the Corporation but not yet signed as commitments and loan and equity investment commitments signed for which disbursement has not yet been fully made (net of cancellations) as of December 31, 2002 and 2001 are summarized below (US$ thousands):

	2002	2001
Investments Approved but not Committed		
Loan	$ 65,555	$ 146,875
Equity	9,000	15,000
TOTAL	**$ 74,555**	**$ 161,875**
Investments Committed but not Fully Disbursed		
Loan	$ 94,494	$ 59,209
Equity	35,449	59,871
TOTAL	**$ 129,943**	**$ 119,080**

The Corporation's loans accrue interest at one-, three-, and six-month London Inter-Bank Offered Rate (LIBOR) plus a spread ranging from 2.50% to 6.00%. At December 31, 2002, the one-, three-, and six-month average LIBOR rates were 1.77%, 1.79% and 1.88%, respectively (3.88%, 3.78%, and 3.73%, respectively, at December 31, 2001).

The maturity structure of the Corporation's loan investments for the years ended December 31, 2002 and 2001 is summarized below (US$ thousands):

	2002		2001	
	Principal Outstanding	**Average Spread Over LIBOR**	**Principal Outstanding**	**Average Spread Over LIBOR**
Due in one year or less	$ 58,019	3.64%	$ 61,489	3.70%
Due after one year through five years	169,853	3.72%	172,562	3.50%
Due after five years through ten years	40,955	3.83%	41,366	4.02%
	$ 268,827		**$ 275,417**	

Loans on which the accrual of interest has been discontinued totaled $62,434,000 at December 31, 2002 ($83,246,000—December 31, 2001). Interest income not recognized on nonaccruing loans during the year ended December 31, 2002, totaled $3,162,000 ($2,634,000—year ended December 31, 2001). Interest collected on loans in nonaccrual status during the year ended December 31, 2002, was $1,271,000 ($47,000—year ended December 31, 2001).

The Corporation's investment in impaired loans at December 31, 2002, was $46,199,000 ($22,128,000—December 31, 2001). The average recorded investment in impaired loans during the year ended December 31, 2002, was $34,164,000 ($15,327,000—December 31, 2001).

Notes to the financial statements

December 31, 2002 and 2001

Changes in the allowance for loan and equity losses for the years ended December 31, 2002 and 2001 are summarized below (US$ thousands):

	2002			2001		
	Loan	Equity	Total	Loan	Equity	Total
Balance at beginning of year	$ 30,421	$ 27,032	$ 57,453	$ 24,409	$ 15,961	$ 40,370
Investments written off	(15,478)	(286)	(15,764)	(5,746)	(3,098)	(8,844)
Recoveries	679	—	679	416	—	416
Provision for losses	30,080	14,400	44,480	11,342	14,169	25,511
Balance at end of year	**$ 45,702**	**$ 41,146**	**$ 86,848**	**$ 30,421**	**$ 27,032**	**$ 57,453**

Regional economic conditions led to recognition of increased risks and related loss provisions in the Corporatin's portfolio during 2002.

In 2000 the Corporation made an investment in a minimum lease payments receivable that is included in loan investments. As of December 31, 2002, the net present value of this investment totaled $4,274,000 ($3,210,000—December 31, 2001), including gross payments receivable of $4,737,000 ($3,555,000—December 31, 2001) with unearned interest of $440,000 ($345,000—December 31, 2001). The Corporation recognized $246,000 in interest income associated with these leases during the year ended December 31, 2002 ($375,000—year ended December 31, 2001). Lease payments to be received over the next five years are as follows (US$ thousands):

	2003	2004	2005	2006	2007
Principal repayments	$ 1,538	$ 1,092	$ 743	$ 513	$ 388
Interest income earned	217	121	64	31	7
Minimum lease payments receivable	$ 1,755	$ 1,213	$ 807	$ 544	$ 395

In 2001 and 2002 the Corporation made investments in certain mortgage-backed securities. In accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* the Corporation has classified these mortgage-backed securities as trading securities and carries them at an estimated fair value of $4,816,000 as of December 31, 2002 ($4,338,000—December 31, 2001). For the year ended December 31, 2002, the Corporation has recorded an unrealized loss of $1,829,000 related to this investment which is reflected in Unrealized (Loss) Gain on mortgage-backed securities (unrealized gain of $515,000—year ended December 31, 2001). The Corporation also entered into derivative financial instruments related to these mortgage-backed securities that are designed to minimize the variability of the interest and principal repayments due to interest and foreign exchange risk. The Corporation has recorded a fair value for the derivative of $1,906,000, which is included in Receivables and Other Assets and represents the unrealized gain associated with the derivative as of December 31, 2002 ($619,000 unrealized loss associated with the derivative reflected in accounts payable and other liabilities at December 31, 2001). In the absence of relevant market data and an active market, management has made certain key estimates and assumptions while valuing these mortgage-backed securities and the related derivative instruments. Key assumptions and estimates include credit risk, prepayments, foreign exchange rates, inflation rates and counterparty risks. Changes in assumptions could affect the fair value of these mortgage-backed securities and derivative instruments.

Notes to the financial statements

December 31, 2002 and 2001

Note D – Receivables and other assets

Receivables and other assets as of December 31, 2002 and 2001, are summarized below (US$ thousands):

	2002	2001
Accrued Income on Marketable Securities	$ 648	$ 384
Accrued Income on Loan Investments	1,818	2,145
Accrued Dividends on Equity Investment	26	174
Derivative Asset	1,906	
Receivable on Equity Sales, net	695	
Recovered Assets	620	620
Other Postretirement Benefit Prepaid Asset		112
Other	711	272
Fixed Assets:		
Office Equipment and Leasehold Improvements, at cost	1,271	1,234
Computer Hardware, Software and Systems Development, at cost	2,561	2,384
Less: Accumulated Depreciation and Amortization	(3,468)	(3,263)
Fixed Assets, net	364	355
Total Receivables and Other Assets	**$ 6,788**	**$ 4,062**

During 2002 the Corporation sold its participation in certain equity investments and recorded notes receivable totaling $2,390,000. The Corporation recognized a $390,000 gain related to these equity sales, which was included in gain on sale of equity investments during the year ended December 31, 2002. At December 31, 2002, the outstanding balance and related loss allowance on this receivable was $747,000 and $52,000, respectively.

Note E – Accounts payable and other liabilities

Accounts payable and other liabilities as of December 31, 2002 and 2001, are summarized below (US$ thousands):

	2002	2001
Accounts Payable	$ 690	$ 564
Due to the IDB	1,271	77
Due to Broker for Marketable Securities	11,164	
Salaries and Benefits Payable	2,304	1,575
Deferred Revenue	428	333
Capital Subscription Residual Payments	341	1,317
Installment Payments on Equity Dispositions	1,383	1,383
Derivative Liability		619
Other Liabilities	287	451
Total Accounts Payable and Other Liabilities	**$ 17,868**	**$ 6,319**

The Corporation enters into agreements with equity investment sponsors to exit the Corporation's positions in equity investments. These agreements involve installment payments made to the Corporation whereupon at the end of the installment payments the Corporation's position is released to the equity investment sponsor. Installment payments reflected in accounts payable and other liabilities totaled $1,383,000 at December 31, 2002 and December 31, 2001.

Notes to the financial statements

December 31, 2002 and 2001

Note F – Borrowings

The Corporation's outstanding borrowings consist of term and revolving credit facilities with Caja Madrid, Mizuho Corporate Bank, and Shinkin Central Bank. Borrowings under the revolving credit facilities are due one, three, or six months after disbursement and are renewable. Borrowings under the Shinkin Central Bank facility are due at maturity.

Credit facilities and the related borrowings outstanding at December 31, 2002, and December 31, 2001, are as follows (US$ thousands):

	2002		2001	
Credit Agreements	**Facility**	**Outstanding**	**Facility**	**Outstanding**
Caja, expired December 2002	$ —	$ —	$ 50,000	$ —
Caja, expiring March 2003	50,000	—	50,000	—
Mizuho, expiring June 2003	100,000	5,000	100,000	55,000
Caja, expiring March 2006	100,000	50,000	100,000	50,000
Shinkin, expiring December 2009	30,000	30,000		—
		$ 85,000		**$ 105,000**

Interest accrues at variable rates based on one-, three-, or six-month LIBOR rates set at the effective date of each borrowing or the interest reset date. The Corporation's weighted average cost of borrowings for the year ended December 31, 2002, was 1.97% (4.71%—year ended December 31, 2001). The Corporation also pays a commitment fee ranging from .05% to .10% on the unused available line of credit. Total commitment fees paid on all lines for the year ended December 31, 2002, totaled $80,000 ($53,000—year ended December 31, 2001).

In 2003 the Corporation signed a $50 million term loan from Caja Madrid that carries interest at a fixed rate. This loan is due and payable in January 2011. Interest is payable quarterly.

In 2001 the Corporation renewed a loan agreement with the Inter-American Development Bank that allows the Corporation to borrow up to $300 million until November 2005. No funds were drawn under this loan agreement during 2002 or 2001.

Notes to the financial statements

December 31, 2002 and 2001

Note G – Capital

The Corporation's authorized share capital was increased to $703.7 million through a $500 million capital increase resolution approved in 1999. The resolution allocated $500 million for subscriptions by member countries during the subscription period. On March 22, 2000, the minimum number of subscriptions required to make the capital increase resolution effective was received. Members have agreed to pay their subscriptions in eight equal installments, the last of which is payable on October 31, 2007. The Corporation issues only full shares. Fractional or advance share payments are held and will be issued in accordance with this installment plan.

The following table lists the capital stock subscribed, subscriptions receivable, and fractional or advance shares pending issuance at December 31, 2002:

	TOTAL Capital Stock Subscribed		Subscriptions Receivable from Members	Payments Received on Account of Pending Subscriptions
	Shares	Amount		
		US$ Thousands		US$
Argentina	7,767	$ 77,670	$ 54,400	$ —
Austria	345	3,450	1,540	8,750
Bahamas	80	800	—	8,750
Barbados	101	1,010	450	6,250
Belize	101	1,010	450	6,250
Bolivia	624	6,240	2,740	8,750
Brazil	7,767	77,670	42,790	6,916
Chile	2,003	20,030	8,210	3,750
Colombia	2,003	20,030	11,490	1,250
Costa Rica	94	940	—	—
Denmark	1,071	10,710	4,760	3,735
Dominican Republic	435	4,350	1,990	2,500
Ecuador	420	4,200	2,940	—
El Salvador	94	940	—	—
Finland	393	3,930	2,390	5,800
France	2,162	21,620	9,600	—
Germany	1,334	13,340	4,430	5,000
Guatemala	420	4,200	1,840	2,500
Guyana	120	1,200	530	5,000
Haiti	94	940	—	—
Honduras	314	3,140	1,380	5,000
Israel	173	1,730	770	1,250
Italy	2,162	21,620	15,360	—
Jamaica	126	1,260	—	—
Japan	2,393	23,930	11,050	6,250
Mexico	5,000	50,000	21,890	158,750
Netherlands	1,071	10,710	4,760	3,750
Nicaragua	314	3,140	2,200	—
Norway	393	3,930	2,390	5,775
Panama	314	3,140	1,650	—
Paraguay	314	3,140	2,200	—
Peru	2,003	20,030	9,900	—
Portugal	182	1,820	1,110	5,867
Spain	2,393	23,930	11,050	50,000
Suriname	30	300	225	—
Sweden	393	3,930	2,390	5,782
Switzerland	1,071	10,710	5,710	2,500
Trinidad &Tobago	314	3,140	1,380	5,000
United States	17,600	176,000	85,050	8,000
Uruguay	857	8,570	4,640	—
Venezuela	4,311	43,110	22,980	7,500
Total 2002	**69,156**	**$ 691,560**	**$ 358,635**	**$ 340,625**
Total 2001	**68,191**	**$ 681,910**	**$ 401,885**	**$ 1,317,124**

Notes to the financial statements

December 31, 2002 and 2001

Note H – Participations

The Corporation mobilizes funds from commercial banks and other financial institutions (Participants) through loan participations, which are sold by the Corporation, without recourse, to Participants. These loan participations are administered and serviced by the Corporation on behalf of the Participants. During the year ended December 31, 2002, the Corporation called and disbursed $5,214,000 ($24,455,000—year ended December 31, 2001) of Participants' funds. The undisbursed Participants' funds commitments were $6,546,000 at December 31, 2002 ($7,872,000—at December 31, 2001).

Note I – Related party transactions

The Corporation obtains some administrative and overhead services from the IDB in those areas where common services can be efficiently provided by the IDB. The Corporation has a lease agreement with the IDB for office space that expired in 2002. The Corporation will be relocating within existing IDB facilities in 2003 and will continue paying rent under the terms of the prior lease agreement until a new agreement is negotiated for the new space.

The Corporation paid the following amounts to the IDB for office space and certain administrative support services during the years ended December 31, 2002, and December 31, 2001 (US$ thousands):

	2002	2001
Office Space	$ 1,116	$ 1,099
Support Services	448	536
	$ 1,564	**$ 1,635**

Accounts payable due to the IDB were $1,271,000 at December 31, 2002 ($77,000 at December 31, 2001).

In 2002 and 2001, no amounts were outstanding to the IDB under an existing loan agreement. See Note F.

The Corporation has advisory service agreements with the IDB. Fees of $300,000 were received for the year ended December 31, 2002 ($475,000—year ended December 31, 2001).

Note J – Retirement plan

The IDB sponsors a defined benefit plan (the Retirement Plan) covering substantially all of the staff of the Corporation and the IDB. Under the Retirement Plan, benefits are based on years of service and average compensation, with the staff contributing a fixed percentage of remuneration, and the Corporation and the IDB contributing the remainder of the actuarially determined cost of future Retirement Plan benefits. The total contribution is based on the aggregate funding method. All contributions to the Retirement Plan and all other assets and income held for purposes of the Retirement Plan are separated from the other assets and income of the Corporation and the IDB. They can be used only for the benefit of the Retirement Plan participants and their beneficiaries, until all liabilities to them have been paid or provided for. Information regarding the accumulated benefit obligation and related assets attributable to the Corporation is not maintained. The total allocated expense to the Corporation for the purposes of the Retirement Plan was $841,000 for the year ended December 31, 2002 ($12,000—year ended December 31, 2001).

Notes to the financial statements

December 31, 2002 and 2001

Note K – Non-pension postretirement benefits

The Corporation also provides certain health care and other benefits to retirees. All current staff who participate in the Retirement Plan and who meet certain requirements are eligible for these postretirement benefits when they retire under the Retirement Plan.

The Corporation contributes an actuarially determined expense to the IDB's Postretirement Benefits Plan (the Plan) annually. The Corporation's portion of total assets is prorated to the Plan based on the Corporation's funding rate and the rate of return on the assets, net of any payments to employees for postretirement benefits. The Corporation funded $382,000 to the Plan for the year ended December 31, 2002 ($220,000—year ended December 31, 2001). Future funding contributions to the Plan are projected to equal the annual actuarial cost.

The following table provides a reconciliation of the changes in the Plan's benefit obligations and fair value of assets and the funded status as of December 31, 2002 and 2001 (US$ thousands):

	2002	2001
Reconciliation of benefit obligation		
Obligation at January 1	$ 7,403	$ 8,141
Service cost	769	727
Interest cost	426	365
Actuarial gain	(41)	(1,830)
Obligation at December 31	8,557	7,403
Reconciliation of fair value of Plan assets		
Fair value of Plan assets at January 1	7,713	7,974
Actual return on Plan assets	(848)	(481)
Employer contributions	382	220
Fair value of Plan assets at December 31	7,247	7,713
Funded status		
Funded status at December 31	(1,310)	310
Unrecognized transition obligation	2,098	2,272
Unrecognized gain	(788)	(2,470)
Other Postretirement Benefit Prepaid Asset	$ —	$ 112

Actuarial gains and losses that exceed 10% of the greater of the benefit obligation or market-related value of the plan assets are amortized over the average remaining life of active participants of approximately 10.8 years. Unrecognized net transition obligations are amortized over 11.8 years.

The weighted-average actuarial assumptions taken into consideration for the calculation of the benefit obligation are as follows:

	2002	2001
Discount rate	6.25%	5.25%
Expected return on Plan assets	7.25%	6.00%

Notes to the financial statements

December 31, 2002 and 2001

The accumulated postretirement benefit obligation was determined using health care cost trend rates of 9.75% for medical, 16.75% for prescription drugs, and 8.25% for dental, for those participants assumed to retire in the United States of America. These rates were assumed to decrease gradually to 5.25% in 2013 and thereafter. For those participants assumed to retire outside the United States of America, a 9.75% health care cost trend rate was assumed.

The net periodic benefit cost consists of the following components as of December 31, 2002 and 2001 (US$ thousands):

	2002	2001
Service cost	$ 769	$ 727
Interest cost	427	365
Amortization of unrecognized transition obligation and gain	(79)	(151)
Less: Expected return on Plan assets	(622)	(584)
	$ 495	**$ 357**

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one-percentage point change in assumed health care cost trend rates would have the following effects:

	One-Percentage Point Increase		One-Percentage Point Decrease	
	2002	2001	2002	2001
Effect on total of service and interest cost components	$ 232	$ 222	$ (188)	$ (180)
Effect on postretirement benefit obligation	1,445	1,297	(1,172)	(1,052)

Governors and Alternate Governors

Country	Governor	Alternate Governor
Argentina	Roberto Lavagna	
Austria	Karl-Heinz Grasser	Thomas Wieser
Bahamas	James H. Smith, CBE	Ruth Millar
Barbados	Reginald R. Farley, M.P.	Grantley Smith
Belize	Ralph Fonseca	Meliton J. Auil
Bolivia	José Guillermo Justiniano Sandoval	Javier Comboni Salinas
Brazil	Guilherme Gomes Dias	Dante Coelho de Lima
Chile	Nicolás Eyzaguirre	María Eugenia Wagner Brizzi
Colombia	Roberto Junguito Bonnet	Santiago Montenegro Trujillo
Costa Rica	Jorge Walter Bolaños	Francisco de Paula Gutiérrez
Denmark	Carsten Staur	Ove Ullerup
Dominican Republic	Francisco M. Guerrero Prats-R.	Luis Manuel Piantini Munnigh
Ecuador	Francisco Arosemena Robles	Alonso Pérez Kakabadse
El Salvador	Juan José Daboub	Luz María Serpas de Portillo
Finland	Pertti Majanen	Matti Kääriäinen
France	Francis Mer	Jean-Pierre Jouyet
Germany	Uschi Eid	Rolf Wenzel
Guatemala	Eduardo H. Weymann Fuentes	Lizardo Sosa
Guyana	Bharrat Jagdeo	Saisnarine Kowlessar
Haiti	Faubert Gustave	Paul Duret
Honduras	Arturo Alvarado	María Elena Mondragón de Villar
Israel	David Klein	Dan Catarivas
Italy	Giulio Tremonti	Vincenzo Desario
Jamaica	Omar Davies, M.P.	Shirley Tyndall
Japan	Masajuro Shiokawa	Masaru Hayami
Mexico	Francisco Gil Díaz	Agustín Carstens Carstens
Netherlands	Hans Hoogervorst	Agnes van Ardenne van der Hoeven
Nicaragua	Norman José Caldera Cardenal	Eduardo Montealegre Rivas
Norway	Olav Kjorven	Age Grutle
Panama	Norberto Delgado Durán	Eduardo Antonio Quirós B.
Paraguay	Alcides Jiménez Q.	José Ernesto Büttner Limprich
Peru	Javier Silva Ruete	Kurt Burneo Farfán
Portugal	Maria Manuela Ferreira Leite	Miguel Jorge Reis Antunes F.
Spain	Rodrigo de Rato y Figaredo	Juan Costa Climent
Suriname	Humphrey Stanley Hildenberg	Stanley B. Ramsaran
Sweden	Gun Britt Andersson	Stefan Emblad
Switzerland	Oscar Knapp	Peter Bischof
Trinidad and Tobago	Keith Rowley	Victoria Mendez-Charles
United States	Paul H. O'Neill	Alan P. Larson
Uruguay	Ariel Davrieux	Isaac Alfie
Venezuela	Tobías Nóbrega Suárez	

Information as of December 2002

Executive Directors and Alternate Executive Directors

Argentina and Haiti	Ricardo R. Carciofi Martín Bès
Austria, Germany, Italy, and The Netherlands	Michaela Zintl Paolo Cappellacci
Bahamas, Barbados, Guyana, Jamaica, and Trinidad and Tobago	Luis Alberto Rodríguez Havelock Brewster
Belize, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua	José Carlos Quirce José Carlos Castañeda
Bolivia, Paraguay, and Uruguay	Orlando Ferreira Caballero Jorge Crespo-Velasco
Brazil and Suriname	Martus Tavares Frederico Álvares
Chile and Colombia	Germán Quintana Luis Guillermo Echeverri
Denmark, Finland, France, Norway, Sweden, and Switzerland	Paal Aavatsmark Robert Pantzer
Dominican Republic and Mexico	Agustín García-López Héctor Santos
Ecuador and Peru	Jaime Pinto Tabini César Coronel
Israel, Japan, Portugal, and Spain	Marta Blanco Yoshihisa Ueda
Panama and Venezuela	José Alejandro Rojas Eduardo Linares
United States of America	José A. Fourquet Jorge L. Arrizurieta

Management and senior staff

General Manager	Jacques Rogozinski
Corporate Finance Division Chief	Steven L. Reed
Financial Services Division Chief	Jorge Zelada
Finance, Risk Management, and Administration Division Chief	Jorge Roldán
General Counsel, Legal Division	Raul Herrera
Executive Senior Counsel, Legal Division	Sarah Fandell
Chief Credit Officer	Mario Mahler
Senior Special Operations Coordinator	Jorge Pacheco

Support staff

Chief Accountant	Shane L. Bateman
Human Resources	Susana Salazar
Senior Portfolio Officer	Rigoberto Ordóñez
Treasurer	Barbara D. McGowan

Secretariat

Secretary	Carlos Ferdinand
Deputy Secretary	Armando Chuecos

Information as of December 2002

Head Office

1300 New York Avenue, N.W.
Washington, DC 20577
United States of America
Telephone: (202) 623-3900
Fax: (202) 623-3815
E-mail: iicmail@iadb.org

Regional Offices

Andean Regional Office

Carrera 7 No. 71-21, Torre B, Piso 19
Edificio Bancafé
Bogotá, Colombia
Telephone: (571) 325-7058 or (571) 325-7059
Fax: (571) 325-7057

Central America Regional Office

Edificio Centro Colón, Piso 12
Paseo Colón, entre calles 38 y 40
Apartado postal 1142-1007
San José, Costa Rica
Telephone: (506) 257-1418 or (506) 233-2543
Fax: (506) 257-0083

Southern Cone Regional Office

Andes 1365, Piso 13
11.100 Montevideo, Uruguay
Telephone: (598-2) 901-6063
Fax: (598-2) 900-8899

Editorial and Production Team

Claudio Debenedetti
Maridale Jackson
Jorge Roldán
Sylvia Sotela
Livia Tolentino
Alejandra Vallejo

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Inter-American Investment Corporation
1300 New York Avenue, N.W.
Washington, DC 20577
United States of America
www.iic.int