SANTIAGO, CHILE

STATEMENT BY
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I. Introduction

Ladies and gentlemen: Twenty-seven years have gone by since the Bank's Governors last met in Santiago. As we open this year's Annual Meeting I would like to convey our heartfelt gratitude to the government and people of Chile for their warm welcome and for the dedicated effort that has gone into the staging of this gathering, to help assure that it will be a productive one.

Our host country is the perfect embodiment of the changes that have swept through Latin America and the Caribbean in the past thirty years. With an exemplary democratic system and orderly economy as a backdrop, Chileans have succeeded in forging broadbased consensus around fundamental objectives and values. Chile has become, quite rightly, a benchmark for our region and for the world.

The Bank, too, has changed a great deal in these past three decades, and not just in size. Its operations and its lending and other instruments are quite different now, as are the challenges before it. What has not changed at all is our institution's social mission and commitment to integration, the legacy of the illustrious Chilean who served as its first president, Felipe Herrera Lane.

May our work during this Forty-second Meeting of the Board of Governors be guided and inspired by the example of Chile and by Felipe Herrera's precepts, above all his commitment to social issues and our Americas that so characterized his work.

Let us turn now to the issues that have brought us here today.

As Latin American and Caribbean nations move into the twenty-first century it is imperative, now more than ever, that they find ways of propelling economic growth to improve the lot of their people, rearranging priorities to push poverty reduction, and social progress concerns generally, to the top of the list. Our region has a vast store of human and material resources to devote to that quest and can tap into a wealth of experience built up through a continuing search to improve the lot of its people. There could be no better instruments with which to tackle today's challenges of dizzying technological change, globalized markets, and a heavily interdependent world economy.

A necessary condition of such progress will be firm political resolve in each of the region's countries to marshal and give a voice to every sector of society, to effectively absorb external cooperation resources, and to give priority to social advancement and welfare policies that leave no group on the sidelines. The ultimate goal is not merely quicker growth but better quality development. This will mean harnessing synergies to achieve more stable growth that is sustainable and socially equitable.

It will be crucial for the region's countries to breach some yawning social gaps and move poverty reduction to the top of their agendas, as a central focus and integral part of development plans in the coming years. Quite apart from the ethical and moral exigencies, we know from universal observation that poverty—and particularly a widespread increase in poverty—can hold back economic growth, imperil democracy, and wreak havoc on the environment. It is a scourge on the Latin American conscience that some 220 million of its people are living in poverty, nearly 45 percent of them utterly destitute.

A nation's income distribution, as a measure of how equitably the fruits of economic growth are being shared, is a key determinant of a society's well-being and of how motivated each segment of the population will be to join in the collective national-development enterprise. Lamentably, the income distribution in the vast majority of Latin American and Caribbean countries is so severely skewed that the region now has the worst distribution of income of any corner of the developing world.

The wealthiest 10 percent of the population account for 40 percent of national income; the poorest 30 percent receive a mere 7.5 percent of the total.

However somber this picture, in the process we should remember and celebrate the real improvements achieved in a host of social welfare and human development indicators in the region over the course of the twentieth century. The impressive progress made in education is one of many examples we could cite. In 1900, on average, 71 percent of the region's people could not read or write. By 1950 the rate had dropped to 47 percent; by last year it had plummeted to 11 percent. The region's performance on this front compares very favorably with experiences elsewhere in the world, the industrialized nations included.

Another human-development yardstick is life expectancy at birth. In Latin America this measure climbed from 29 years, on average, in 1900 to 47 years in 1950 and 70 years in 2000. The key to these improvements is of course reducing infant mortality. A century ago, 291 infants of every 1,000 live births did not survive beyond their first birthday. According to 2000 statistics, the ratio is now 25 per 1,000.

Fertility rates in Latin America and the Caribbean have trended down, mirroring socioeconomic and cultural shifts. The region's 1950-1965 average was about six children per woman of childbearing age; today the figure has come down to about 2.6.

Declining mortality and fertility rates also have been key determinants of overall demographic shifts and have shaped the present profile and makeup of the region's population.

First, population totals in Latin America and the Caribbean have risen more swiftly than anywhere else in the world, the mean annual increase having climbed from 1.9 percent in the first half of the twentieth century to 2.5 percent in the latter half—2.1 and 3.1 times higher, respectively, than OECD averages. At the dawn of the twentieth century the region made up barely 4 percent of the world's population. Today the figure is closer to 9 percent: our region is home to almost one in every ten people on the planet.

Second, the region's diminishing mortality and fertility rates are shaping not just overall population growth but the age distribution of the population as well. This will have some very weighty social and economic consequences as far as demand for education services, pensions, health care, and job creation are concerned.

Third, along with its robust population growth the region is witnessing a staggering increase in the ratio of urban to rural dwellers. This is placing unprecedented demands on countries that are trying to advance their economies and is jeopardizing social progress. In 1900 only 24 percent of Latin Americans lived in cities; by the end of the century the urban share of the population had soared to 79 percent. The forecast for 2025 is 85 percent.

II. A new millennium, a new century, a new decade

A. Latin American economic progress in the twentieth century: a search for paradigms and globalization

Just how far has the region's economy come, and why have Latin America and the Caribbean still not managed to address the demands of a rapidly growing and increasingly urbanized population, to ease and ultimately eradicate extreme poverty and set the stage for improvements in well being in which every sector of the population can share fairly?

I think it would be worthwhile to look back for a moment at some highlights of Latin American economic history, since there are valuable lessons to be learned from the region's successes and failures alike.

1. 1950-1980: Growth and restructured economies

The prevailing economic and social policy in Latin America in the thirty-year span beginning in 1950 looked essentially to the New Deal experiment that had proved successful in the United States and to the Keynesian paradigm.

In the wake of the collapse of the international monetary and free-trade systems and sharply curtailed capital and investment flows, after two world wars and the Great Depression, nations on either side of the north Atlantic formed into closed, discriminatory blocs. Latin America was left with only one option: look to its own markets for growth, adopting the so-called "inward-looking" approach to development whereby a nation sought to make the most of its own resource potential. At the heart of the process was a proactive State, the engine of economic and social progress and direct administrator of part of the nation's production apparatus.

This economic policy model prized import-substitution industrialization as a way of boosting and diversifying output, modernizing the technology base, creating employment (notably in urban areas), and supplying the domestic demand for goods.

On balance, the region gained from the process, with undeniable improvements in the economy and in social conditions. Regional GDP growth was rapid and steady, edging up from 5.1 percent annually in 1951-1960 to almost 6 percent in 1961-1980. Overall regional production of goods and services increased nearly fivefold during those three decades as an expanding manufacturing industry came to contribute a growing share of total output.

Institutional advances in the region took the form of new central banks, a savings and loan association system for housing finance, national development planning systems, modern higher education institutions, national science and technology systems, and tax system overhauls.

In the post-war era, industrial capital formation was the focus of Latin American economic development, to fuel sustained growth and help countries restructure their production apparatus and technology base. On average, gross domestic investment as a percentage of GDP all but doubled in Latin America and the Caribbean between 1950 and 1980, from 17.7 percent to 29 percent. Until 1973, internal saving kept pace with investment, the cumulative figures for savings and investment being virtually identical. From 1974 to 1980, however, investment increases outpaced the rise in savings, leaving a shortfall equal to about 3 percent of GDP annually. The region turned to external capital to bridge the gap.

Despite the region’s generally positive showing over this period, there were signs early in the nineteen-seventies that the post-war development model was losing currency and that some moves to achieve its main targets were at odds with others. The central aim of efficient import substitution was proving to be elusive. Countries stiffened trade protection, making it expensive to produce goods for the home market and leaving the region’s products at a competitive disadvantage abroad. In the process, the balance of payments became increasingly more vulnerable. By the early nineteen-eighties Latin American and Caribbean exports accounted for only 4 percent of world trade, down sharply from their 12 percent share three decades before. What is particularly dispiriting about this slide is that the world economy was soaring at the time. In the end, while the newly industrialized nations of Southeast Asia were making the most of this historic opportunity, our region let it slip by.

2. Economic turmoil in the eighties: The "lost decade"

The nineteen-eighties were a true prime meridian, marking the closing of one fundamental chapter in Latin American economic development and the opening of another. The post-war development paradigm, already on the wane, broke down completely when Mexico's external debt crisis in September 1982 spilled over into the rest of the region. Meanwhile, the region was taking the first steps toward a new model that would give rise, in succession, to drastic recessionary adjustment measures, ever more sweeping structural reforms, and external debt rescheduling agreements in countries behind on their payments. The breadth and depth of the debt crisis varied considerably from one country to another, taking a heavier toll on some economies and domestic finances than on others. Likewise, some countries were quicker than others to launch adjustments and reforms. Nevertheless, there were certain common threads that can serve us as regional points of reference.

The external debt crisis was the turning point for the post-war economic growth policy. The abrupt drop in aggregate demand on world markets that had preceded the crisis, triggered by oil price hikes that raised the cost of oil tenfold, in constant terms, between 1970 and 1980, coupled with rapidly mounting interest-payment obligations, left countries unable to pay back the debt they had amassed through external borrowings since 1973 to finance a growing share of capital projects, budget deficits, and private consumption. Net inflows of external capital to the region skyrocketed to a peak of 5.8 percent of GDP in 1980-1981, after which, in 1982, the flow stopped altogether.

As a result of the debt crisis and countries' macroeconomic adjustment moves, gross domestic investment declined 1.7 percent annually, on average, in the nineteen-eighties. Prospects for economic growth, improvements in technology, and sustained improvements in social welfare dimmed considerably, particularly for the region's poorest. This explains the slide in annual GDP growth to barely 1.6 percent in 1980-1990 and the 0.4 percent annual drop in per capita output over that same interval. Inflation became an endemic ill, and more than one country had to grapple with hyperinflation.

The manufacturing sector that had spearheaded economic expansion in preceding years reported very lackluster growth, trailing overall GDP increases. Meanwhile, unemployment and urban poverty hit critical levels, attesting to the high social cost of balancing the macroeconomic accounts in the early nineteen-eighties.

Despite these difficulties, Latin American and Caribbean countries honored their debt commitments. Between 1982 and 1990 the region transferred somewhere on the order of US$230 billion to external creditors—the equivalent of two full years of exports, or 50 percent of the cumulative debt stock at year-end 1982.

3. The orthodox reaction

The so-called “lost decade” left a mixed legacy in the region. On the minus side were the heavy toll taken on Latin American and Caribbean economies and the huge sacrifices asked of their people. On the plus side were some definite gains and a series of lessons learned on which the region’s countries built as they moved on to a new phase of economic and social development. The international environment also changed enormously over those years as the production and finance sectors joined in the process we would soon come to call globalization, the allocation of economic resources was turned over largely to the marketplace, and the all-powerful State apparatus was dismantled accordingly.

As more and more countries implemented economic adjustment programs they launched sweeping structural reforms. The scope and content of the reform moves mirrored ambivalencies in economic and political debates in the region about how best to resolve the crisis of the nineteen-eighties. By the end of that decade there was, at least in some measure, a meeting of minds in Latin America as to the soundest course, particularly in government policy circles.

The structural reforms set in motion in the eighties and deepened in the nineties by a growing number of the region’s countries focused initially on combating inflation and easing controls on prices and markets. Subsequent targets were financial, currency, and trade systems. The sequencing of the reforms and their magnitude varied considerably from one country to another.

As the structural reforms advanced, the region moved resolutely to reinstate democracy, and budding democracies everywhere in the region began to flower. Over the course of these years countries set about strengthening the institutions of democracy.

Let us take stock of the region's economic progress in the nineteen-nineties. A first very significant achievement was economic stabilization. By the close of this period the vast majority of countries had brought inflation down to the single digits, in sharp contrast to the situation in 1990.

Second, economic growth has been lackluster and unsteady, averaging just 3.3 percent a year. The region's economies are expanding far too slowly to create enough jobs, reduce poverty, and propel long-term growth. Per capita output edged up only 1.5 percent a year during the decade. At that rate, it would take nearly fifty years to double per capita GDP, an economic growth timeframe that is unacceptable for the present generations.

Third, balance-of-payments deficits widened alarmingly. In the last two years the current-account balance of the region as a whole barely topped 3 percent of GDP.

A fourth feature of the nineteen-nineties was a return to hefty net capital inflows to the region, but the makeup and financing terms of this highly volatile influx were not suited to Latin American and Caribbean development needs. These inflows soared in the early years of the decade, from US$5.7 billion in 1989 to US$68.7 billion in 1993, and the region made the most of them to put through anti-inflation policies and structural reforms.

The influx became extremely unstable in subsequent years, in the wake of the 1994 Mexican financial crisis and turmoil in Asian economies in 1997 and in Russia in 1998. In no time these crises spilled over into many other nations' currency and financial markets, threatening the stability of the international financial system at every turn. A sizable share of the funds flowing into Latin America took the form of foreign direct investment, which countries tend to welcome because it is relatively stable and brings with it technology, organization, and market entrées. However, the bulk of this investment went to the larger and more advanced countries in the region where it was used largely to acquire existing assets, typically privatized State enterprises, or for bank or other corporate mergers and acquisitions.

All these experiences pointed up just how much external factors can influence the region's growth, and how vulnerable its economies are to events beyond their borders. The main lesson we can draw from the experience is that countries are far more financially fragile than we thought, and that the impact of a financial crisis on their growth and prosperity will depend on how deeply indebted each country is and how much it relies on inflows of volatile or short-term capital from abroad. Since external factors are such a strong determinant of growth, it is clear that many of the most effective policy measures for Latin American growth will be closely tied to the reconfiguration of the international financial architecture.

B. The forces of globalization

Latin America and the Caribbean have no choice but to "go global". For countries in our region, globalization is the avenue to unprecedented growth and a modern technology base, but it is not without serious risks. The challenge will be to seize all the opportunities while endeavoring to diminish and, ideally, avoid the down side.

The task awaiting Latin America and the Caribbean is as difficult as it is inescapable. The most pressing challenges will be to: (i) boost internal saving and narrow external financing gaps to shield economies from outside financial turbulence; (ii) entrench macroeconomic stability and stabilize domestic finances; (iii) assure the continuity of core economic policy tenets; (iv) craft medium- and long-range national and sectoral economic development strategies to help optimize the contribution of external savings; and (v) deepen reforms and bolster the oversight apparatus to enhance local capital market transparency, information, and competition.

The region also needs to strengthen its export capacity, redoubling efforts to develop its dynamic comparative advantages and diversify its products and export markets. One key requisite for export development is an increase in value-added content in tradable-goods production. Coupled with productivity gains, such improvements can check, in the medium and long run, the secular decline in terms of trade. Moves to expand and deepen regional and subregional economic integration arrangements and trade accords with other parts of the world, in pursuit of “open integration”, offer Latin American economies another very promising way of girding themselves against adverse external events.

As Dani Rodrik has pointed out, globalization also needs solid “institutionality” in countries committed to the process. This means government institutions equipped to make and administer public policies with a long range view, along with political stability, strong democratic institutions, and input from the citizenry into State decisions. Other requisites are judicial and political processes that are predictable and credible, including an enabling legal framework for the growth of private enterprise, protection of property rights, government accountability, and honest, transparent, efficient administration of the State. A final institutional requirement is a social safety net for the most vulnerable groups who are displaced as nations modernize and restructure production, or are buffeted by business-cycle swings that are the inevitable corollary of market liberalization and globalization.

III. Uncertainty at the dawn of the twenty-first century

A. Formidable strengths, serious frailties

Our region’s nations are stepping into a new decade armed with some major strengths—democracy, stability, fiscal and monetary responsibility, more open economies, and tightened regional integration ties, to name but a few. Some critical weak points are high poverty rates; lags in long-term growth; markets that have yet to integrate fully into the global marketplace; the relatively small number of manufacturers that are accounting for most export sales and the low value-added content of those products; high unemployment and low saving and domestic investment; the vulnerability of the region’s economies to instability outside their borders; an extremely lopsided income distribution, and flagging productivity.

B. The challenge of competitiveness

There are some undeniable challenges ahead as the region moves into the twenty-first century. Our countries are producing far below their potential when one considers the economic resources at their disposal and current productivity prospects. Especially discouraging is the opportunity cost in terms of social advances that this is entailing for our countries. But we should look at these same circumstances as a window for growth, which will open even wider if our economies redouble their efforts to become globally competitive. No one is claiming that this enterprise will be short or simple: ultimately, it will put to the test the region's true desire for progress.

What triggered this huge gap, and how can we make up for lost time?

We do not need a rigorous formal analysis to discover the main reasons for the region's lag. First and foremost was the dip in long-range growth rates which, adjusted for high population growth, has pushed per capita income back twenty years. Across most of the region the economic recovery of the nineties was shaky at best, nowhere near robust enough to take employment, real wage, or productivity growth back to pre-crisis levels.

One formidable challenge for Latin America's economies is to achieve more efficient production and make more efficient use of economic and human resources. Productivity gains are imperative if the region is to step up economic growth and equip itself for global competition. Achieving this goal is the true desideratum of the collective economic and social development enterprise. Productivity is not everything, but in the long run it is almost everything, as Krugman phrased it. A just and progressive society expects the fruits of productivity improvements to be shared equitably among workers and business and capital owners. Let us look briefly at the productivity issue in our region and the associated challenges.

The region has fallen behind, for a number of reasons, in the race to global competitiveness. Some are part and parcel of countries' own economic performance, the nature and pace of technological innovation, and the efficacy of current policies. Other factors are more complicated, having to do with too little schooling and poor quality of education, low labor productivity (the result of meager investment in human resources and inadequate technical and management training), the high cost of capital owing to operating inefficiencies and too little competition in the financial sector, gaps in access to basic energy, transportation, and communications infrastructure, and shortcomings in the institutional apparatus and its operation, political stability, and social equity.

One of several firm obstacles to overall economic growth and productivity improvements is investment, which has been languishing in the region. In the last two years, overall regional investment rates were barely 20 percent of GDP, on a par with averages posted in the throes of the economic crisis of the nineteen-eighties, and not far off the nineteen-nineties average. This is in striking contrast to the seventies' average of 28 percent of GDP. Boosting annual growth to 6 percent in the region in the coming years will require a hefty increase in productive capital formation on the order of nineteen-seventies numbers, that is, around eight additional percentage points of GDP. The productive capital base needs to be expanded to supply economic and social infrastructure needs, augment and restructure export capacity, help businesses replace plant and equipment to bring in modern technologies, and so on.

But this is only one facet of the challenge. If we aspire to an equitable society we need economic growth robust enough to remedy the problem of unemployment and create gainful employment for a growing workforce.

Technology lags in the production sectors and pronounced disparities between sectors–and between companies operating in the same sector–are relatively common features of underdevelopment in the region. Because they have been slow to bring in, adapt, and disseminate technologies, many of our businesses are nowhere near the international technology threshold and have instilled few international best practices. This is widening the technology divide between the region's nations and their industrialized counterparts.

Technological progress in industrial centers has rewritten longstanding rules on comparative advantages that, prior to the Second World War, dictated the specialization of commerce. Productivity gains more than offset differences in cost associated with abundant (or scarce) labor or natural resources. Expanding and diversifying the region's exports in today's globalizing economy is therefore a challenge requiring extremely close attention and support, to narrow the technology gap that is keeping productivity down in the region and harming its chances to compete internationally.

Another determinant of competitiveness is economic stability, which means not only achieving and maintaining monetary, fiscal, and currency exchange balance but also assuring the rule of law and respect for the laws. Our countries have made considerable strides in this regard over the past fifteen years that they can build on down the road. We must acknowledge, however, that external threats to stability persist and that we lack the checks and capacity to stave them off or cushion their aftermath.

Redoubled efforts thus are needed to reduce these economies' external vulnerability. In addition to expanding and efficiently diversifying market and export structures, domestic savings need to be boosted and financial systems improved. The recent international financial crises have proven to be extremely virulent and rapidly contagious, with pernicious effects even in the region's fastest-growing and most stable economies. But in order to lessen external vulnerability, aside from expanding internal savings and investing them better, adjustments are needed in the magnitude, makeup, and terms of the external capital flows required to augment domestic savings.

Thus, the challenge for regional development is to spur growth and economic transformation by improving productivity. The object of policies to enhance competitiveness are to: (a) promote technology development, adaptation, and dissemination; (b) encourage businesses to improve their organization and management and bring in modern production methods and technologies; (c) foster investment and production of tradable goods; (d) provide small and mid-sized businesses with opportunities to upgrade their technology and improve their organization and management; (e) promote the modernization and expansion of transportation and communications infrastructure; and (f) improve the quality of human resources, with an emphasis on technical and job skills training.

To accomplish these goals we need to overcome current policy constraints and find better tools. Neither the mature industrial powers nor the newly industrialized Asian countries managed to grow, modernize institutions, or advance technologically without a good dose of sectoral policies and targeted incentives. Why should Latin America and the Caribbean, with their enormous development gaps, remain defenseless and passive, wasting their production potential and chances for progress?

C. The social challenge

To reduce poverty and enhance equity countries need stable, sustained long-term growth. But cause and effect flow in the other direction as well. There can be no sustained economic growth without social development. The result of unequal access at the starting line – to education, land, or credit, for instance – is slow growth. When there are no social protection systems in place, people are reluctant to take the kind of risks that can improve economic returns, not to mention the deleterious effect of the lack of a social safety net on the physical and human capital of the poor.

Growth that fails to extend opportunities to the masses can end up interrupting or even reversing economic reform gains, give rise to populism, and weaken democracy and social tranquility. Social ills also have a heavy economic cost, associated for example with law enforcement and security services to curb crime, high student dropout rates, and broken homes. To achieve economic and social development, countries need policies to provide more equal opportunity, including measures to level the playing field from the start.

Participation and social inclusion at the country and local levels are essential to ensure shared growth and break the vicious cycle of poverty. The population needs to feel that it has a say in, and some responsibility for, national and local decisions. Alienation breeds discontent and violence. A real voice in decisions and processes of change are necessary ingredients in any effort to make institutions more transparent and responsive—these being keys to economic and social progress.

All of this was explicitly acknowledged by the Bank's Governors in the Eighth Replenishment document.

Prospects for poverty reduction are particularly threatened by economic upheavals and instability. Over the last twenty years there have been more than forty episodes in which annual per capita income fell by more than 4 percent. This shows us that economic crises strike hardest at the poor and defenseless, and that per capita consumption and real wages in these communities plummet in times of crisis, as unemployment rises.

Coming to grips with poverty therefore requires a general strategy and policies designed to:

- Create opportunities for the social and productive integration of the poor and the excluded. This means continuing with the traditional social reforms: education, health care, nutrition, improving poor neighborhoods, rural social infrastructure, microenterprise, etc. But it also means creating equal opportunities for access to productive assets.

- Build a social dimension into economic policy. This means addressing the distributional implications of policy measures, and not just policies expressly designed to protect the poor, promote adjustments with equity, prevent crises, etc.

- Establish social protection programs, for instance allowances to dispossessed families as incentives to keep their children in school or as a way of augmenting their income now and strengthening the human capital of future generations.

D. The integration challenge

After a decade of turmoil, Latin America and the Caribbean saw a dramatic surge in regional integration moves in the nineteen-nineties within the framework of the so-called "New Regionalism", underpinned by considerable political momentum.

However, as the new millennium approached, upheavals in the world economy, natural disasters, and domestic political problems began to place strains on some regional processes, particularly in the major subregions. There is a perception now that regional integration in Latin America and the Caribbean has come to a crossroads.

That said, we should not lose sight of the real progress made over the past decade to advance the region and heighten its competitive edge in a globalized economy.

- Most goods traded in the region are now duty-free or circulating under agreed tariff phase-out timetables.

- The surge in regional trade has made our economies very heavily interdependent. One interesting fact is that regional trade has a much higher knowledge content than extraregional trade. Regional markets have provided an outlet for exports such as food products and textiles that face stiff protection elsewhere in the world.

- A number of regional economic accords are laying the groundwork for gradual economic coordination and have already facilitated productive joint negotiations in regional and hemispheric forums.

- Today, our nations are actively pushing for economic integration with industrialized nations—a move that would have been inconceivable fifteen years ago—as reflected in NAFTA, the Canada-Chile Free Trade Area, ongoing free-trade talks between Canada and Central America, Canada and CARICOM, the United States and Chile, the European Union and MERCOSUR and Chile, and, of course, the Free Trade Area of the Americas (FTAA).

- The increase in intraregional trade and the accompanying investment have prompted demands for improvements in regional infrastructure and the abolition of national rules and requirements that have been holding up those processes. The South American regional infrastructure initiative launched by the Heads of State in Brasilia last year with technical and financial support from the IDB, CAF, and FONPLATA, is a testament to the positive spillovers of the New Regionalism, as is the "Puebla Panamá" plan unveiled in Mexico City a few days ago, with IDB and CABEI backing.

- Regionalism and the awareness that the region's governments share common concerns have helped forge partnerships to cement peace, further development on our borders, and entrench democracy. The democracy clauses in MERCOSUR and Andean Community instruments have inspired discussion of similar commitments within the framework of the hemispheric summits.

This list of achievements is long and impressive. Why, then, the feeling that regional integration is losing momentum?

Changes in government, external turbulence, and foreign trade competition can slow the launching of new integration arrangements and make it more difficult to sustain existing ones. The region's history is replete with initiatives that started out promisingly, only to fail. After nearly a decade, the "easy" stage of the New Regionalism in Latin America and the Caribbean may well be over, and a bolder political vision may be needed to push through more sweeping collective commitments. The regional accords of the nineteen-nineties were put together by dint of a heavy expenditure of political capital that has paid off handsomely. It would be a tragedy to forfeit that investment. The core challenges that lie ahead could be summed up as follows:

- **Eliminating nontariff barriers**. As border barriers or tariffs are lowered, nontariff barriers are revealed to be a second significant tier of obstacles to trade and investment. These impediments, coupled with the regional partners' own market rules and policies, are politically difficult to remove because this impinges more directly on the domestic sphere. However, leaving these obstacles in place will make it that much more difficult to reap the benefits of regional integration and will raise the economic and political costs of any new initiative.

- **Transparent dispute settlement mechanisms**. Intraregional trade and investment should be a handmaiden of economic transformation. As the volume of trade increases among intraregional partners new disputes will arise as well. As we have seen in trans-Atlantic trade, even the best of trading partners can have rancorous disputes over small fractions of total trade. It is important, therefore, that there be formal, transparent dispute settlement and contingent protection mechanisms to regulate the regional market.

- **Liberalizing** trade **in services**. Accelerating the liberalization of services is essential to achieve closer integration. This will permit greater specialization and efficiency in the service sectors, which in turn will make for efficient goods production and trade.

- **Macroeconomic and monetary cooperation**. The increasing interdependence of members of regional groupings demands closer macroeconomic and monetary cooperation to mitigate episodes of instability. The prime goal in this area is country convergence around sustainable macroeconomic positions that can make intraregional economic relations more predictable, boost regional trade, and enlarge markets. Later on, this goal could be combined with heightened macroeconomic and monetary cooperation.

- **Modernizing institutions**. Two other requisites for deeper Latin American and Caribbean integration are modern institutions and capable staff. Efficient institutions are needed to oversee rights and obligations and ensure an equitable political voice and distribution of benefits among partners.

- **Intangibles**. Three intangible elements are required to successfully deepen integration: (i) political vision and commitment, particularly on the part of the dominating market country; (ii) a collective commitment to promoting equitable distribution of benefits and costs among partner countries as well as encouraging a better distribution within countries; and (iii) public understanding, participation, and ownership of the integration process.

- **Further structural reforms**. The role of integration as a preparatory process for globalization requires that member countries comply with their Uruguay Round obligations and plan for further gradual unilateral liberalization as part of the ongoing structural reform process.

An important backdrop to our regional integration process is the FTAA, which is scheduled to take center stage in 2005. This process has progressed steadily since its inception in 1995, first with a very successful preparatory stage, and then with a fairly advanced stage of negotiations that have produced bracketed texts of an agreement that will be submitted to Trade Ministers next month in Buenos Aires.

We should all be proud of this progress. It is clearly one of the major achievements of the hemispheric summits. This success would not have been possible without the political commitment of all thirty-four governments and the resolute and fiscally costly dedication of delegations who have negotiated nearly continuously in the FTAA Secretariat.

As I mentioned to the trade ministers at their Toronto meeting in November 1999, even while we wait for an agreement to be penned by 2005, the FTAA process has been generating tangible and important benefits since its inception. To mention just a few: the creation of an esprit de corps among our trade units that has facilitated bilateral agreements in other fields; increased transparency of hemispheric trade-related rules and trade data; important business facilitation measures, especially in customs procedures; promotion of a hemispheric business community; and hands-on experience in many complicated regional and WTO-related trade issues.

But the main payoff will be an agreement by 2005. A successful agreement must advance trade liberalization in the areas of the region’s comparative advantage–agriculture, for example–and those of special interest to the more advanced partners, such as services. One major impact of the agreement would be institutional modernization propelled by competition, the need to attract foreign investment, and the adoption of trade-related disciplines and institutions. All this will be encased in a set of rights and obligations that ensure more secure market access not only between our region and North America but between subregions as well.

What effect will the FTAA have on existing agreements in the regions? Some agreements with limited objectives will undoubtedly be absorbed by the FTAA. This would not necessarily be bad, as it will help harmonize trade-related rules in the hemisphere and simplify the mélange of different agreements and rules in the region. The more solid and deeper arrangements should coexist with the FTAA. Thus the urgency of significantly deepening the agreements that exhibit political commitment and economic relevancy. Indeed, the FTAA itself might indirectly support deepening by constructing a more solid foundation of discipline to support current regional agreements.

We also should bear in mind that the FTAA and subregional agreements are two very different products. The FTAA is akin to a hypermarket, attending to the tastes of a broad hemispheric clientele. Subregional integration is the neighborhood store. The services provided by both the hemispheric and regional stores are essential if our countries are to successfully confront today's challenges for development, equity, and good governance in an era of globalization.

It is therefore reasonable to expect some countries and blocs to pursue a two-track or even multiple-track strategy in regional integration. This explains why countries and blocs in Latin America and the Caribbean are not limiting their horizons to the region and hemisphere but also are actively pursuing agreements with the European Union and Asian countries while awaiting another round in the WTO.

The prospects for an FTAA in 2005 seem good. The negotiation process is advanced and a few delegations even support moving the closing date for negotiations. It would be my view that focusing on concerted procedures for moving forward as quickly as possible, while ensuring that negotiations address substantive concerns for a balanced agreement, is more important than a formal advancing of the closing date as such.

E. The challenge for institutions and democracies

Despite institutional advances and the strengthening of democracy in recent years there still are difficulties, constraints, and uncertainties that pose challenges for the region in the decade ahead. The heartening democratic climate in the region cannot mask certain effectiveness and credibility problems of institutions. Shortcomings in the political, institutional, and regulatory spheres are limiting their capacity to serve and respond to the needs of the citizenry and are dampening domestic saving and investment, thereby slowing economic growth.

As progress has been made in economic reforms, our region's countries have found that the workings of the marketplace sometimes come up against the traditional structure of State institutions, changeable government management approaches, the absence of modern public policies, obsolete legislation, weak democratic checks and balances, and limited avenues and institutions for public input, negotiation, and consensus building.

These persistent institutional and democratic shortcomings notwithstanding, there is no question in the region but that democracy is a sine qua non for development. Without the solid and democratic rule of law, it is impossible to build the institutions that the market requires to run efficiently or to have a State that discharges its core responsibilities—fostering competition, promoting justice and equity, and narrowing the gap in our societies between those at the forefront and those who are bringing up the rear.

Our history and the history of the industrialized nations teaches that the effectiveness of a State's actions does not depend solely on its technical capacity and the instruments at its disposal. It is equally crucial that such actions be detached from private or corporate interests and seek the common good. In a democratic system, public policies tend to pool, process, and respond better to the demands of the citizenry. Government officials can also be made accountable for their actions. People living in a democracy expect there to be no dramatic changes in the ground rules without the benefit of democratic debate by representatives of all walks of society. This instills the kind of certainty and trust in political and legal systems and processes that sets the stage for sustained savings and investment. Only this will assure that a broad consensus exists when it comes to shaping and implementing State, rather than simply government, policies that provide a sense of direction and continuity.

The consolidation of institutions and democracy also demands solid public management capacity in central governments and, particularly, in local governments, since they have been shouldering an increasing share of responsibility for the delivery of public services.

It is not surprising, therefore, that in recent years a strong consensus has emerged regarding the importance of democratic institutions for promoting solid policies for sustainable and equitable development. This awareness has broadened the sphere of action of international cooperation agencies where governance issues are concerned, and we can say proudly that the Bank has been in the forefront of this movement in development thinking and practice. Since the Eighth Replenishment, we have been supporting the region's democracy-strengthening efforts, providing financial and technical backing for projects for justice-system reform, modernization of legislatures, and more effective oversight and compliance monitoring agencies, among other democracy-building focuses.

IV. Incomplete economic and social progress: Some questions

A. Have the reforms failed?

In view of the insufficient progress made in the reforms undertaken in recent years, we should not be surprised that opinion polls reflect the public's disappointment, frustration, and often anger. In particular, these exercises indicate that the public's main worries are unemployment, job instability, economic uncertainty and vulnerability to economic crises, escalating violence – including domestic violence – and crime, lack of access to basic services, rural isolation owing to inadequate infrastructure, the breakdown of families that comes from migration to the cities and abroad, and mistrust of State institutions.

In these circumstances, the following questions become inevitable:

- Have the reforms failed?
- Is the region's disappointing economic performance an inescapable consequence of globalization?
- Do we need to construct a new paradigm to guide relations between the State and the marketplace?

These are the main issues on which it is worth reflecting, to guide the debate.

The first point is to recognize that we know what the reforms have cost but not what the costs would have been had the reforms not been carried through. The Bank's estimates suggest that, without the reforms, annual average growth in regional GDP would have been almost 2 percent lower than at present.

The second is to remember that not all countries in the region have proven to be equally vulnerable to upheaval on international commercial or financial markets. These differences teach us valuable lessons on how to design more efficient mechanisms to protect against external shocks.

The third is to note that our countries have learned from the experience and are exploring new ways of overcoming failures by markets and governments. These new approaches are based on the recognition that the State has a key role to play in market growth and in enabling citizens to capture the private and social benefits that ensue when markets run efficiently.

B. An agenda for collective action

What are the central issues on our countries' development agendas? Despite widely differing conditions from one country to another, some common features can be extrapolated from an overview of economic and social progress in the region. The picture points to five major areas of vulnerability.

1. Poverty

The region's top priority should be combating poverty and the widespread inequality, unemployment and exclusion in our countries. Comprehensive strategies are required to address these problems, targeted to: (i) creating economic opportunities for the poor; (ii) attacking structural inequities in asset distribution, and (iii) improving access by the poor to economic and social infrastructure. A comprehensive strategy should include mechanisms to cushion the impact on the poor of catastrophes associated with disease, natural disasters, economic crises, violence, etc., and initiatives that respond to the needs and priorities of the poor; to promote investment in social capital, and to combat the social and political exclusion of indigenous and Afro-Latin peoples.

2. Competitiveness

Latin American and Caribbean countries need to significantly step up the pace of growth if they are to reduce poverty and rise to the demands of their citizens for jobs and social progress. To tackle this formidable challenge, the countries must boost their capacity to compete internationally, making the most of their resource base. This will mean continuing and deepening reforms to strengthen financial systems, education and job training systems, national innovation systems, and labor markets. It also means fostering private enterprise and helping microenterprise and small and medium-sized businesses grow, investing in infrastructure, and striving for broader regional economic cooperation.

In this context we must recognize the role that has been played by the Multilateral Investment Fund in fostering private-sector development throughout the region as well as faster economic growth and social development in regional member countries, based on sound economic policy and increased private investment. It is prudent, then, that we consider the need to resource the Fund such that it may continue to support ongoing work by broad-based economies to develop their economies.

3. Good governance

It will not be possible to design or execute effective growth, poverty reduction, or macroeconomic stability policies and programs or to achieve greater domestic social integration in a context of political and institutional weakness. Modernization of the State, understood as the political and institutional apparatus of our countries, is therefore an inescapable task. The fragility of our State and civil society institutions is the true Achilles heel of our development efforts. To conquer this weakness there need to be continued efforts by countries to bolster their macroeconomic and microeconomic management capacity, continue with justice-system and legislative reform, improve the workings of local government, foster social dialogue, civic coexistence, and citizen security, combat corruption, and promote transparency. The Bank has firmly supported regional efforts to curb corruption. Its initiatives to this end are embodied in the new anti-corruption policy recently approved by the Board of Executive Directors.

4. External vulnerability

The region is vulnerable to external events as a result of its relatively modest levels of domestic saving, the fragility of the fiscal balances of the consolidated public sector, shortcomings in financial regulation and supervision, the excessive concentration of our exports, and our high dependency on primary commodity prices. One way of confronting this vulnerability is to continue strengthening integration moves. This means that our countries will need to cooperate more closely in steering their development policies toward better use of their resources, in a manner that is compatible with the objectives of greater complementarity in their economies.

5. The environment

Without doubt, one of the most serious challenges for the region is to manage its natural resources in a way that is consistent with economic growth, social equity, and environmental sustainability. Latin America and the Caribbean are among the world's leading producers of agrifood, forest, fish, and mining products. Rational use of these resources requires public policies designed for their sustainable management and a strategic vision that can make them a springboard for the transformation of production patterns.

To respond to these five challenges, development policies need to be designed and implemented to:

- Ensure the maintenance of an enabling environment for market operations, creativity, and the restructuring of production, and for equitable distribution of the fruits of economic growth.
- Guide the actions of economic and social agents by identifying long-range objectives, including poverty reduction targets, and proposing a strategic vision for coordinated action by the private sector, civil society, and the State.
- Contend, as necessary, with externalities that hobble optimum market behavior.

C. The Inter-American Development Bank

The changes in the economies of the Bank's borrowing member countries in the last decade and the different kinds of demands that governments and societies are posing today present challenges for our institution as we embark on this new century. Our proposal for addressing those challenges, which has been described in detail in the document presented yesterday to the Committee of the Board of Governors, can be summarized in ten conclusions:

- The current international debate on the role of the multilateral development banks is both timely and necessary. The Bank will have to adopt clear positions to enable the Governors to participate actively and constructively in that debate.

- The rethinking of the Bank's role should take due account of changes in the member countries' economic and social structures in the last decade and the impact of the globalization of the region's economies. These factors have led to renewed demands on Bank action.

- A rethinking of objectives to underpin a new cooperation agenda should be based on ratification of the objectives already marked out by the Governors during the Eighth Replenishment and on a sharper focus for some of them, in areas linked to the new realities and demands of the countries.

- The Eighth Replenishment objective of a frontal attack on poverty should continue to be the cornerstone of our action, as part of an ambitious social development agenda that calls for efforts for greater equality in employment opportunities and the inclusion of groups that have been on the sidelines of economic and social progress.

- The new approach to the Eighth Replenishment aim of modernizing public and private institutions will be a focus on issues of governance and competitiveness. Good governance is a compelling objective of all structural changes and development policies in our countries. Competitiveness is a fundamental tool for faster and better quality economic growth, in whose absence real social progress would be impossible.

- Integration lies at the heart of the Bank's mission and has become a fundamental objective of the individual and collective actions of countries in the region. This objective should be a high priority in institutional cooperation policies.

- Environmental considerations should continue to inform a comprehensive sustainable development agenda for the region's countries.

- The Bank's new action fronts based on the foregoing considerations should be focused, sustained, and prioritized by the Governors.

- The Bank already has a toolkit for action arising from the Governors' mandates. It would be highly desirable for the Board of Executive Directors to make these instruments more flexible. This would, of course, be accompanied by suitable arrangements to enable Management to evaluate results.

- The entire exercise should keep in mind the comparative advantages of an institution such as ours, which has been present in the region for over forty years. Among these advantages are the borrowing member countries' sense of ownership of the Bank, our institution's ongoing contact and open, candid discussions with governments and public and private stakeholders in the development process, and its commitment, since its inception, to social issues, integration, and other concerns.

In consultation with its member countries, the Bank has always come up with innovative responses to challenges. I hope this list can serve as a starting point for discussions in the Board of Executive Directors and the Committee of the Board of Governors, who are called upon to steward our institution in responding to the challenges it faces today. Our goal is clear: to identify institutional changes that will better equip the Bank to serve the development needs of the peoples of Latin America and the Caribbean today.

Ladies and gentlemen: These are the same peoples, the same earth, once evoked by one of Chile's illustrious sons and citizens of the world. Who better than the celebrated poet Pablo Neruda to paint a picture of our region in words:

Primordial America
Your purple-hued lands guarded
by two oceans
Centuries of quiet industry,
pyramids, the potter's craft,
rivers of blood-red butterflies,
amber volcanos
and silent races,
Shapers of vessels,
carvers of stone.