

**MINUTES**  
**XVI Meeting of the Latin American Network of Central Banks and Finance Ministries**  
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**Session I. Global and Regional Outlook**

David Robinson began his presentation by noting that world economic data has been strong in recent months, with relatively strong growth in the United States and Emerging Asia and steady growth in the Euro area. Growth in Latin America, however, has been slack, and Japan is displaying negative growth of approximately 1%. World growth is estimated at 2.7%.

Although a sustained recovery has not yet occurred, industrial production and trade volumes have bottomed out. In addition, the recovery is proceeding, like the recent recession, with major regions in approximate synchrony. Significant differences nonetheless exist in each major region's indicators.

In the U.S. economy, the inventory correction has run its course, and the labor cycle is bottoming out. The sustainability of the recovery in the second half of 2002 remains in question, though, as consumption remained strong during the recession and may not increase. Additional investment, which is not a given, may be necessary to maintain U.S. momentum.

The Euro area has experienced a less dramatic slowdown than the United States and is in turn experiencing a less pronounced recovery that will lag U.S. developments. At the same time, however, business confidence is up, especially in Germany, and a more balanced recovery is expected in Europe than in the United States.

Japan, experiencing its third steep recession in a decade, is showing signs of bottoming out, with growth of over 0% possible for 2002. Deflation and structural problems, particularly in the banking sector, nevertheless continue to pose long-term challenges.

In emerging regions, Emerging Asia, especially Korea, is experiencing a recovery based on renewed demand in the information technology sector. Latin America presents a mixed picture, with stronger growth in countries closely tied to the United States, moderate growth in Brazil, and an ongoing difficult situation in Argentina.

Continuing sources of uncertainty remain. The most notable of these is oil prices, subject to increase on the basis of both growing demand and political instability among producers. Of further concern is the U.S. current account deficit, the future financing of which is in doubt given a decline in foreign direct investment flows to the United States; a sharp decline in capital flows to the United States may cause a disorderly adjustment in the U.S. dollar.

Robinson further noted that the relative mildness of the recent recession was based on a combination of luck, relatively low oil prices, improved macroeconomic fundamentals in many nations and exchange rate resilience in developing countries. Advising policymakers to take advantage of the current climate to make additional improvements, he suggested that the United

States needs to determine the appropriate rate at which to withdraw stimulus as the recovery continues, as well as tighten fiscal policy, while Japan needs to take a more aggressive approach to structural reform.

Assessing global financial markets, Charles Blitzer observed that the September 11 attacks exacerbated the trends prevailing at the time, which have since given way to leveling and recovery. While technology stocks and the NASDAQ remain weak, emerging market instruments have proven strong in recent months as investors have regained an appetite for risk. The U.S. recovery, accompanied by a decline in default rates, has led to a strong dollar, and expectations of monetary tightening in developed economies other than Japan have been reflected in higher forward rates for the United States and Canada.

In emerging markets, EMBI spreads have declined notably since October, particularly as investors have decoupled Argentina from other emerging market expectations; it is additionally significant that markets had positioned themselves for Argentina's crisis in advance of the December 2001 default. Emerging market funds have experienced significant dedicated and cross-flow increases as investors, perceiving that fundamentals have improved in many emerging markets, seek risk diversification and higher yields. While emerging market debt issues are widely available to investors, these issues are generally denominated in US dollars; Euro-denominated debt is being issued primarily in the "convergence" countries preparing for European Union membership.

Blitzer cited several areas for concern regarding financial markets. The first was rich valuations, with high price/earnings ratios, that could leave markets vulnerable to earnings disappointments. A second and related issue involved widespread concern regarding the transparency and integrity of corporate accounting in the wake of the Enron scandal in the United States. A third area was a decline in nonfinancial commercial debt issues, which risks increasing calls on bank credit lines and worsening corporate profitability and liquidity. Fourth, debt service to income ratios for both households and corporations are rising high in the United States, in spite of low interest rates.

From the perspective of emerging markets, monetary tightening in the United States and Europe has the potential to increase spreads, produce greater risk aversion, and cause cross-over investment to leave emerging markets, especially Latin America. Additional concerns for Latin America include recoupling of Brazil and other regional economies to Argentina should the Argentine peso go into a free fall, the region's high level of reliance on foreign direct investment as opposed to portfolio investment or bank lending, and financial markets' concerns regarding political developments in Brazil, Venezuela and Colombia.

Presenting the regional outlook, Arturo Galindo discussed the constellation of factors currently affecting Latin America. In addition to global factors such as the recession in the United States and Europe, the region has been buffeted by low commodity prices, particularly for non-fuel primary goods, and a decline in terms of trade since the 1997 Asian crisis. The region's stalled recovery since the shocks of 1997 and 1998 has been reflected in the region's largest economies by an outflow of non-FDI capital since the beginning of 1999 and a general decline in FDI flows since the third quarter of 1999. The Central American countries, however, which are

more closely linked to the United States than most of the region's larger economies, have experienced a less pronounced decline in total investment and continuing inflows of non-FDI capital. An additional favorable development is that, with the exception of Argentina, the risk premia of most countries in the region have returned to levels not greatly above those at the time of the Asian crisis.

The stalled recovery of most of the larger countries in the region since 1999 has been driven by the failure of investment, unlike consumption and exports, to return to or exceed 1998 levels. The larger economies' recovery has in most instances been thwarted as well by increasing oil prices and increases in both nominal and real exchange rates, accompanied by strong contractions in the current account balance and an increase in public sector debt, the latter producing an unsustainable fiscal situation. In this environment the region's larger economies have experienced the unusual combination of declines in both real lending interest rates and volume of real credit, which suggests inefficiencies in financial intermediation. The Central American economies, on the other hand, have not witnessed declines in credit, and their interest rates have remained stable.

## **Session II. The Course of Reforms in Latin America**

Eduardo Lora's presentation assessed the region's structural reforms in relation to the region's modest economic growth during the reform era and widespread public disillusionment with structural reforms. This disillusionment has been particularly acute among the middle classes, who have borne the brunt of privatization measures, which in many instances appear to have been tainted with corruption.

While structural reforms are ongoing in the region, the pace of reforms has been uneven across sectors as well as countries. Early and profound trade liberalization has been lagged by financial sector, privatization and tax reforms, while almost no labor market reform has taken place. The reforms that have taken place depend largely on the quality of institutions, and they entail the risks of inducing macroeconomic instability and worsening income distribution.

These concerns have led to a variety of proposals posing alternatives to the highly market-oriented "Washington Consensus" of the 1990s. Incremental approaches include greater use of counter-cyclical fiscal and monetary policy, improving social security and social services, and increasing tax collections from the rich. More radical proposals include extensive reform of international financial institutions, reversal of some trade and financial liberalization measures, and the institution of debt reduction and alternate lending mechanisms.

Arturo Valenzuela discussed the region's prospects in relation to current challenges to structural reforms and democracy, noting that the problems of democracy can only be solved by means of democratic processes. Within the region he cited the recent successes of Mexico and Central America in managing political changes and furthering democracy within a constitutional framework. Factors that favor democratization include a previous history of democracy and a strong national identity, though it is additionally necessary to create majority-based governments or governing coalitions and strengthen institutions to ensure the continued success of both democracy and structural reform.

He cited several systemic challenges to democracy in the region. The first consists of unrepresentative electoral systems with contests among candidates of weak, fragmented and corrupted parties. The second involves public institutions' inability to provide services, including minimal security to the population in some instances. The third is a lack of accountability and transparency in politics and policymaking, which has led to widespread public rejection of the political classes. Fourth, some countries in the region face underlying problems of governability as a result of the inability to form majority governments and/or federal systems; these difficulties can be exacerbated by an emphasis on a strong presidency that may not enjoy support from other political actors.

Other participants raised a variety of questions regarding the presentation. Guillermo Calvo asked what the role of the international community might be in the reform process, and how countries can advance when confronted by a high degree of external influence. Pablo Guidotti suggested that in the case of Argentina the systemic soundness of the political system had been subordinated to economic goals such as the maintenance of Convertibility; concentrating additional powers in the presidency to address the current crisis would further undermine the political system over the long term. Assessing reform processes, Vincent Reinhart suggested that countries are faced with a choice between maintaining a steady average growth rate and accepting variance between higher and lower growth rates over time. Enrique V. Iglesias noted that the development of democracies depends in part on the institutions of civil society, and that a parliamentary system depends on the strength of political structures such as parties in order to function properly; given these conditions a European political model may not be appropriate for all countries.

### **Luncheon Address**

Discussing proposed arrangements for sovereign bankruptcy proceedings, Anne Krueger stated that an orderly institutional procedure could minimize the pain involved in a debt workout. At the same time, she noted that the establishment of these procedures has been held back by countries' reluctance to become involved, difficulties in organizing creditors, and the fear of litigation from holdout creditors. Contrasting an institutionalized statutory approach with a contractual approach, she stated that a statutory approach that would affect all contract and thereby shape the rules of the game would prove superior to a contractual approach that would operate on a case-by-case basis and would allow for differing interpretations of contracts across jurisdictions.

She enumerated several features of the statutory approach. First, it would involve most, if not all, creditors in the workout process and thus preclude forum-shopping on the part of litigious holdout creditors. Second, a statutory approach would ensure responsible sovereign behavior by barring payments to non-priority creditors and making protection of a sovereign debtor contingent on policies designed to produce stability. Third, as in a bankruptcy court, independent validation of creditor claims could take place, based on a principle of inter-creditor equity, and new credit would not be included in a sovereign bankruptcy arrangement. She observed that several questions remained within this framework, including the treatment of Paris Club debt and sovereign held by domestic creditors.

In the question and answer period, Guillermo Calvo asked how the determination is made of a sovereign's insolvency. Ms. Krueger responded that monitoring of sovereigns is already underway, using measurements that include a country's primary capital surplus. Guillermo Perry asked how collective action clauses might be linked with the statutory proposal, to which Ms. Krueger stated that the IMF could possibly induce creditors to exchange other forms of debt for instruments that contain collective action clauses.

### **Session III. Obstacles in the Road to FTAA**

Robert Devlin assessed the Americas' progress toward a hemispheric free trade agreement as a progress that has made great progress but one that is currently at a critical juncture. He noted that the process has already produced a variety of positive externalities, including the following:

i) the resolution of bilateral disputes; ii) intergovernmental transparency and shared databases; iii) business facilitation measures; iv) providing an opportunity for smaller countries to develop negotiation skills; v) providing a catalyst for sub-regional activities; vi) contributing to the development of multilateralism through innovations such as the FTAA's data reporting system; vii) encouraging Europe to engage in trade liberalization with Latin America, and viii) encouraging the formation of a hemispheric business community.

He stated that challenges nonetheless remained in completing the FTAA process. These include addressing asymmetric research and negotiating capabilities of countries, furthering interministerial cooperation within countries, obtaining policy inputs from civil society, and enabling countries to monitor the agreement in order to protect their own interests. Challenges for individual countries include compensating for lost tariff revenues, maintaining macroeconomic equilibrium and a competitive exchange rate, obtaining access to credit, attracting new investment, and compensating losers in the economic adjustment process. In relation to other agreements, sub-regional arrangements will have to be deeper than the FTAA in order to remain relevant, and the question of how the FTAA will interact with Europe remains to be decided. He suggested that furthering the process additionally depends on mainstreaming trade and regional integration into countries' development agendas, with accompanying assistance from IFIs.

Ernesto Stein's presentation discussed the potential for regional integration areas to produce winners and losers among member countries and the resulting implications for the FTAA. One area for possibly differing effects on countries within a regional integration area involves trade creation and trade diversion effects. While regional integration generally increases trade for members with intermediate comparative advantages and reduces trade for countries with extreme comparative advantages, at least in a small or sub-regional integration, the wide range of comparative advantages that exist among countries in the hemisphere is likely to counteract the potential losses that producers and suppliers might otherwise experience. In terms of FDI, common membership in a free trade agreement approximately doubles bilateral FDI, and doubling the size of the market to which a host country has access increases FDI by an estimated 6%. Increases in FDI, however, are unlikely to be distributed evenly among the members of a

free trade area. Dilution effects can occur, particularly as countries favored in a sub-regional agreement may lose their attractiveness in a wider agreement, as is anticipated with Mexico once the FTAA is implemented. In addition, more developed and open countries are likely to gain more than others, as are countries with advantages such as favorable locations and strong institutions.

In his presentation, Jaime Zabudovsky stated that for many countries the FTAA serves as a lever of structural reform as they make their economies more competitive. He nonetheless noted that the FTAA process is complicated by the number of participants, the heterogeneity of those participants, the coexistence of the FTAA with other accords, and the simultaneity of the FTAA with other negotiations. Subject areas of particular concern include countries' treatment of politically sensitive goods such as citrus, sugar and textiles, finding ways to verify compliance with rules of origin in countries with widely varying capabilities, and coordinating action among countries with greatly differing political calendars and electoral cycles. Other concerns include uncertainty in how to implement financial regulations across countries and how to coordinate and monitor implementation in areas such as public purchases and intellectual property.

Other participants raised a variety of issues regarding the presentations. Mario Alonso stated that very clear dispute-resolution mechanisms will be needed to ensure the proper functioning of the agreement, while Isaac Cohen raised the questions of how smaller countries and losers in the integration process will be compensated and of how the IDB will assist in this process. Alicia García Herreros noted that in comparing regional arrangement the difference between the objectives of the FTAA and the European Union must be taken into account, and that in a regional trading arrangement a tradeoff exists between transparency and speed in action.

#### **Session IV. Monetary Coordination for Integration in Latin America**

In his presentation Rodrigo Valdés questioned the value of monetary coordination as a feature of regional integration. He noted that, with a few exceptions, Latin American countries depend primarily on trade outside of the region, and that for the region as a whole trade represents a smaller percentage of GDP than in other regions such as the Euro area; wide variations in countries' terms of trade further complicates a trade-based approach. In addition, the regions' countries are not experiencing the real exchange rate convergence that would make monetary coordination feasible or desirable. A third difficulty is that exchange rate coordination does not lend itself to being used simultaneously with inflation targeting, which assumes a free float regime; a more practical approach might consist of real exchange rate coordination among countries. Finally, countries differ greatly in their size and macroeconomic conditions, countries, including their ability to manage counter-cyclical policies. These asymmetries within the region effectively prevent monetary coordination in the foreseeable future, and explicit exchange rate targets may even prove destabilizing; the best policy approaches that can realistically be expected in the near future are the avoidance of crises and the possible use of inflation targeting by countries with similar economic conditions.

Eduardo Fernández-Arias' and Ernesto Stein's presentation addressed the problems that arise when exchange rates are not coordinated among the countries of a trade agreement, particularly in the aftermath of Mercosur member Brazil's 1999 devaluation. While exchange rate overvaluation generally reduces exports and FDI, and increases currency crises, these effects can be intensified when misalignment occurs between members of a regional integration agreement. Exchange rate consistency is thus essential for sustainable trade agreements. Means for achieving this consistency include unilateral policies such as choices of trade agreement partners and exchange rate regime, policy coordination through measures such as macro coordination or a currency union, and finding means of support in international financial architecture, whether through IMF monitoring and conditionality or through a regional monetary fund.

Among the comments made after the presentations, Guillermo Perry asked under what circumstances do currency divergences become a serious problem, noting that divergences are not always a problem and that overvaluation can be worse for some countries than others. He further mentioned that a smaller economy in a trade agreement needs greater flexibility than a larger partner. Mario Alonso stated the importance of the real economy, as not all problems can be resolved by means of exchange rates. Eduardo Lora observed that factors other than trade are relevant in examining exchange rate policies. Guillermo Calvo noted that regional integration and currency arrangements can have different impacts on resources that can be moved, such as manufacturing plants, and those that cannot, such as beaches.

### **Session V. Lessons from Argentina**

Ernesto Talvi's presentation examined Argentina's current crisis in relation to international financial conditions following the 1998 Russian default. The resulting sudden stop in capital flows to emerging markets was followed by a lasting increase in the cost of credit for emerging markets, a sharp current account adjustment and deterioration in the exchange rate, and a cyclical contraction followed by only an anemic recovery, especially in investment. Under these conditions countries' vulnerability was determined by three factors: i) levels of public debt; ii) financial mismatches; and iii) the openness of the economy, measured as the ability to adjust to adverse external conditions. In contrast to Chile, which displayed low vulnerability, Argentina displayed high vulnerability in all areas. Among the policy lessons that can be derived from this experience is that closed economies with high levels of external and public debt and large financial mismatches are particularly vulnerable to changes in international conditions; this situation appears to prevail regardless of the exchange rate regime in place.

Umberto Della Mea discussed Uruguay's economic situation in relation to developments in Argentina. He stated that while Uruguay has experienced a reduction in tourism from Argentina and a decline in terms of trade, Uruguay's fortunes are not entirely linked to that of its larger neighbor. Uruguay has benefited from maintaining exchange rate flexibility, pursuing a policy of inflation targeting, and diversifying its debt portfolio. Maintaining liquidity and solvency in the banking system has additionally enabled Uruguay to lessen the impact of the Argentine crisis.

Guillermo Escudé surveyed the history and effects of Convertibility in Argentina. While Convertibility initially provided a response to hyperinflation, there eventually arose a tendency to subordinate other goals to maintaining the effective peg to the dollar. This eventually made the costs of abandoning Convertibility very high, even if doing so was inevitable. In fact, Convertibility was ended only after as a result of an unusual convergence of circumstances and events. First, it eventually became clear that a currency peg did not guarantee fiscal discipline. Second, after the 1998 Russian crisis financial markets became increasingly risk-averse. Third, the devaluation of the real delivered an additional shock to Argentina's current account. Finally, advocating the end of Convertibility was a politically unacceptable position that no official wanted to take in the short term; this political dilemma delayed the end of Convertibility but increased the difficulty of the transition. One of the policy lessons from Argentina's experience, according to Mr Escudé, is that hard pegs, while suitable for small countries with large export customers, may have less value for larger and more diversified countries. A second lesson is that inconsistent or misguided policies do not combine well with a rigid exchange rate regime.

Armando Pinell discussed Bolivia's experience as a highly dollarized economy. He stated that the country's experience represents a continuation of the difficulties of the 1990s, with slowing growth rates and diminished portfolio capital flows; maintenance of high levels of FDI, however, has helped to lessen volatility. The lessons that can be derived from Bolivia's recent experience include the following: i) banks should maintain both liquidity and reserves, as well as avoid excessive holds of government debt; ii) strict financial supervision and prudential regulations prove beneficial; and iii) a moderate fiscal policy, with an emphasis on inflation reduction, has further benefited the country. The remaining risks for a highly dollarized economy are that debtors may lack the ability to pay dollar-denominated debts, and that departing from dollarization is a difficult process that entails the danger of hyperinflation. An additional danger is capital flight in response to unfavorable conditions. Additional policy recommendations that can be derived from Bolivia's experience are that the holding of deposits and assets should be encouraged in local currency and/or accounting units based on the local currency and that maintaining a competitive real exchange rate should be a major policy goal.

Renzo Rossini surveyed Peru's recent economic history and its relation to a high level of dollarization. Dollarization increased in the late 1990s as a result of shocks including sharply declining terms of trade, uncertainty produced by the Russian default and the El Niño phenomenon, and the political crisis attending the end of the Fujimori presidency. More recently, however, dollarization has begun to decline as the country has entered a period of greater political and economic stability; this has been accompanied by a decline of sovereign debt spreads to pre-crisis levels. Peru's growth prospects are additionally improving as a result of a favorable confluence of circumstances and policy. Relevant factors include an improving current account situation, increasing control of the fiscal deficit, movement toward greater transparency in the Central Bank, and progress toward inflation targeting; in addition, Peru's banking system has maintained liquidity by keeping approximately 30% of dollar deposits in reserves. Peru's monetary policy of decreasing dollarization has so far functioned because local currency is being used for transactions and salary payments; in addition, the Central Bank frequently takes action regarding interest rates to avoid currency mismatches. As dollarization reflects defects in local markets, de-dollarization may reflect an increase in the range of local investment options.

In discussion following the presentation, Eduardo Fernández-Arias suggested that Peru's decreasing dollarization was anomalous and raised the question of whether public debt issued in local currency might crowd out private borrowing in that currency. Guillermo Perry observed that in an economy characterized by large changes in capital flows dollarization may not represent a sustainable approach; in addition, dollarization may not be appropriate when trade with the United States represents only a small portion of a country's trade. Alonso Pérez Kakabadse suggested that, under dollarization, countries experiencing capital account and balance of payments problems would have recourse to only a narrow range of policy instruments in the absence of an independent Central Bank.

## **Session VI. Argentina: What Next?**

Jorge Todesca characterized the climate of Argentina as one of public frustration with the policies of the 1990s, which have caused instead of avoided crises. He noted that the Argentine government's first priority is to contain the current economic crisis to prevent it from extending throughout the financial and political system; of particular interest is preventing a collapse of the banking system. While the country's economy is in a time of great fragility, initial signs of recovery include the beginnings of a new business cycle, adjustments in prices to reflect the end of convertibility, and some signs of activity in exports; tax collections, moreover, have appeared to bottom out at the end of a period of significant declines. In order to return the country to a sustainable growth path the government is undertaking policy initiatives in the areas of macro conditions, financial system arrangements, public debt management, and improving the business and investment climate. These measures include seeking an overall 1.3% primary surplus for the national and provincial governments and engaging in monetary expansion in preparation for inflation targeting. Future policy directions include financial system reforms such as narrow banking and restructuring of public banks, public service reforms to adjust prices while maintaining current levels of investment and service, and encouraging business activity by measures such as bringing Argentina's bankruptcy laws closer to international standards and paying greater attention to creditors' concerns.

Augusto de la Torre's presentation focused on the state of the financial system and the exchange rate regime. He stated that the success of measures involving the financial system depends on a local currency that is a credible store of value and in which loans may be issued. In the short term, Argentina should greatly reduce the corralito system of limiting bank withdrawals but convert a substantial portion of deposits into dollarized time deposits. Any proposal to convert deposits into longer-term bonds must overcome significant credibility problems; means for addressing the credibility issue include regular interest payments for this type of debt and giving it seniority over types of debt, as well as providing ways to make these bonds a fluid instrument. In the longer term, the following measures appear desirable: i) preventing public banks from engaging in high-risk lending or borrowing; ii) ensuring that tradable and non-tradable sectors are financed in the appropriate currency, with possible indexation of financial contracts to reduce uncertainty; and iii) instituting narrow banking with high liquidity and deposit requirements, as well as an avoidance of "first come-first served" withdrawal procedures that lead to a run on banks.

Kristin Forbes' presentation focused on the importance for Argentina of establishing credibility by announcing widespread reforms and then maintaining the announced course of action. The suggested reforms covered four areas. The first involved financial system measures, most prominently the ending of corralito withdrawal limits according to a clear schedule, with possible interim measures such as a gradually decreasing withdrawal tax and a market for trading deposit bonds. Other possible financial measures include banking system reforms and a revised bankruptcy law undertaken according to a firm timetable, as well as a strengthening of deposit insurance. A second goal, the achievement of monetary credibility, depends on a group of measures including the timely retirement of quasi-currencies, setting and adhering to realistic targets in the issuance of pesos, and moving in a timely fashion toward a clearly defined monetary regime, perhaps with inflation targeting. The third objective of establishing fiscal credibility requires improving tax collection, possibly through centralizing related information systems and arresting high-profile tax evaders, reducing expenditures, and basing budgets on realistic assumptions, perhaps in conjunction with cyclically adjusted revenue and expenditure targets. A fourth objective is obtaining credibility with IFIs, which can result only from the undertaking of clearly defined and closely followed policies that place Argentina on a sustained and realistically based path of growth and recovery.

Pablo Guidotti's remarks surveyed current problems, possible government actions, and Argentina's prospects. The problems included the following: i) capital and liquidity difficulties brought about by the corralito; ii) uncertainty regarding how to restructure the debt, particularly in terms of different treatment of creditor classes; iii) the absence of a viable fiscal program; iv) monetary uncertainty attending exchange rate restrictions and the use of quasi-currencies; v) inadequacy in the rule of law, particularly regarding contracts and privatized enterprises; and vi) the absence of a framework for monetary and exchange rate policy. If it is assumed that the current crisis is temporary, it is necessary for the country's long-term well-being to maintain privatization, refrain from nationalizing the banking system, eliminate quasi-currencies and exchange rate controls, and open the national economy dramatically. Additionally, the following sequence of measures is necessary to ensure a stable foundation for recovery: i) the corralito must be greatly reduced or eliminated as soon as possible, with any bonds in place of deposits being perceived by financial markets as profitable; ii) a well-defined monetary program must be put in place; iii) public expenses, deficits, and debt must be contained; and iv) an independent monetary policy must be established. In terms of alternatives, while a period of inflation with a weak currency may be acceptable during a time of renewed growth, inflation in a highly regulated economy with little growth is bound to prove politically unacceptable.

In the discussion following the presentations, Guillermo Calvo suggested that differential narrow banking requirements could be imposed for different currencies. Jorge Todesca stated that some of the suggestions made by the presenters, including deposit insurance and alternate approaches to the financing of non-tradables were under consideration by the Argentine government. He also noted that the most recent fiscal pact with the provinces includes a clause ending the issuance of new quasi-currencies, with depreciation of quasi-currencies in relation to the peso and the expected reabsorption of quasi-currencies by the national and provincial governments; this initiative is being taken place in relation to an ongoing revision of federal-provincial relations.

## **Session VII. What Detains Growth in Central America?**

Chair Manuel Agosin's presentation covered Central America's failure to experience high growth and increasing income convergence with developed countries in spite of favorable trends such as the end of civil wars in the region, the return of foreign capital, structural reforms, and an increase in macroeconomic stability. He noted that Central America's modest GDP and income growth are the apparent consequence of low levels of investment, especially in comparison to high-growth developing countries such as Singapore and Chile. Investment in the form of imported machinery and equipment, which is closely related to growth, has remained low in region, and human capital investment measured in years of schooling remains well below that of the United States.

Mario Alonso presented a mixed scenario for Central America, particularly for Nicaragua. He noted that progress in consolidating democracy and furthering development is taking place without adequate resources, with resulting performance that does not meet expectations. The region's successes, though, include increasing macroeconomic stability, regional integration, and a process of trade liberalization that furthers structural reform. Short-term growth prospects remain modest as a result of high prices for oil, which the region imports, and low export prices for coffee. Longer-term challenges include furthering the rule of law by reforming slow, inefficient and corrupt judicial systems and producing greater accountability in public institutions, and raising social investments in health, education, housing and the environment. Further development of both financial and real markets is needed as well.

The policy prescriptions he advocated included a well-defined strategy of development financing at both national and regional levels. Within this framework, financial regulation should take place increasingly at the regional rather than the national level in order to take advantage of economies of scale, and the Central American Development Bank should be better utilized in furthering regional development. In addition, investment should be directed to the productive sector.

Roberto Rivera Campos assessed El Salvador's economy in relation to growth, macroeconomic factors and the impact of dollarization. In spite of the end of the civil war, structural reforms and substantial remittances from Salvadoreans working in the United States, growth has declined since the mid-1990s. Growth has been held back largely by shocks such as high oil prices, low coffee prices, declining demand for Salvadorean exports from the United States, and earthquakes in recent years. Macro conditions remain favorable, however, with low inflation and interest rates resulting from a highly dollarized economy. The sustainability of macro stability and dollarization, however, remain matters of concern. The long-term viability of a dollarized economy will depend on increasing productivity, while in the medium term containing fiscal deficits will continue to pose a challenge.

Rolando Guzmán surveyed growth, factor accumulation and productivity in the Dominican Republic from 1950 to 2000. During this period the Dominican Republic displayed stable growth in comparison to most Latin American countries in spite of numerous social,

political and institutional changes, as well as major changes in economic policies. This growth is largely explained by high levels of investment in physical capital, increasing labor participation rates among women, and steadily increasing levels of schooling.

Andrés Rodríguez-Clare examined the questions of why Costa Rica has grown slowly in spite of favorable conditions, particularly during the recent liberalization period as opposed to previous periods. This situation is in part explained by slow growth in worker productivity, which has counteracted the effects of strong increases in labor participation. The effects of slow increases in labor productivity, tied to reductions in schooling during the 1980s, are exacerbated by fiscal restrictions on public investment in the 1980s and 1990s, and by high interest rates' dampening effect on private investment. The growth of employment in the service sector, rather than higher-productivity sectors such as agriculture and industry, also explains slow growth. Policy recommendations include increasing fiscal discipline and reforming the financial sector in order to reduce interest rates, and examining possible means of expanding the industrial sector such as depreciating the real exchange rate, entering into a free trade agreement with the United States, and improving the business climate.

Eduardo Weymann discussed Guatemala's difficulties in achieving sustained growth in spite of trade and financial liberalization and regional integration. Growth is particularly held back by high interest rates, appreciation of the currency, low tax revenues and insufficient investment to stimulate growth. The consequent low levels of job creation and high levels of informal employment have brought about increases in poverty and inequality, thus preventing the country from taking advantage of its demographic transition. Measures needed to alleviate the current situation include the deepening of structural reforms, higher levels of foreign direct investment, additional international aid, and increased spending on social programs and human capital.

Following the presentations participants addressed several other issues related to Central American development. Mario Alonso observed that official tourism promotion initiatives in Costa Rica and Nicaragua have proven counterproductive, as they encourage the entry of uncompetitive operators; he additionally noted that he does not see Nicaragua moving toward dollarization. Manuel Agosin noted that increased schooling levels do not necessarily lead to higher productivity levels and that investment in machinery is necessary. He further pointed out that the region suffers from high spreads and high real interest rates, and that the maquila sector, which hires but does not buy locally, has little connection with national economies as a whole. Roberto Rivera Campos stated that volatility in growth is largely associated with political volatility, and Andrés Rodríguez-Clare stated that Costa Rica may pursue dollarization as a means of addressing its fiscal and investment problems.