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PROMOTING ECONOMIC OPPORTUNITY IN THE AMERICAS: IDB'S ROLE*

AEI, Washington
Luis Alberto Moreno
IDB President

GREETINGS

GOOD afternoon! It's a great pleasure for me to visit the American Enterprise Institute for the first time in my new capacity as President of the Inter-American Development Bank. One of my main missions at the IDB is to transform it into a true "ideas bank". I think there is much our institution can learn from successful ideas-driven organizations like the AEI, and I look forward to a closer relationship between our two institutions in the years ahead.

I want to especially thank Ambassador Roger Noriega and the AEI for this invitation. I also want to greet my distinguished co-panelists, my friend Ambassador Jaime Aparicio, John Murphy and Jane Thery, and to thank all of you for your interest in our region and in the work of the IDB.

Let me provide a brief general overview of the situation in Latin America and the Caribbean and some of the key priorities of the IDB, which I hope will help to frame our discussion.

THE REGION'S OUTLOOK

It is an interesting time in Latin America and the Caribbean. On the one hand, the economic trends are the best they have been in 25 years. After more than five years of near stagnation, average annual growth in the past two and a half years topped 4.9%. For this year, growth is projected at a healthy 4.3 to 4.5%, and a similar rate is expected for 2006.

Moreover, despite the recovery of domestic demand and high oil prices, inflation is the lowest it has been since the 1960s. On average, inflation in the region's economies has fallen from over 11% in 2002 to around 5.5% currently.

* President Moreno's speech appears on the Inter-American Development Bank's website at <http://www.iadb.org/news/article/detail.cfm?language=en&fname=luis%20alberto&lname=moreno&parid=5&arttype=sp&artid=2718>. The *Law and Business Review of the Americas* gratefully thanks the Inter-American Development Bank for its permission to reproduce this speech.

Most importantly, these improvements have begun to make a dent on poverty, after a half-decade of deteriorating social indicators. Indeed, ECLAC recently reported that 13 million people left the ranks of the poor in the region between 2003 and 2005, bringing the over-all poverty rate down to 40.6% of the population—still, a staggering 213 million people, of which 88 million (16.8% of the total) live in conditions of extreme poverty.

THE EXTERNAL ENVIRONMENT

It is important to recognize the significant role that the external environment has played in this recovery. The main transmission mechanism has been the strong prices for basic raw materials, due largely to the continued economic expansions of the United States and China.

But most of all, Latin America and the Caribbean have benefited from the benign international financial environment of recent years. The period from mid-1997 to 2002 was one of strong capital outflows from emerging markets. In the past two years this situation has reversed, with inflows to developing economies totaling \$99 billion in 2004. The recovery in capital flows has been accompanied by an impressive increase in asset prices. Shares in Latin America are up 174% in the past two years, and the region's stock-markets are among the world's best performers.

DOMESTIC POLICIES

Although the external environment has played a key role in the recent recovery, I would like to underscore the role that domestic macroeconomic policies are playing, because in many respects there have been very healthy developments, especially when compared with previous booms. In fact, I believe that in general terms, regional economies have never been better managed.

It is worth noting that during the current recovery phase, fiscal policy has been conservatively managed in most countries; traditionally, poor fiscal management contributed to accentuating the economic cycle and, thus, intensifying instability. The average fiscal deficit in Latin America has fallen from 3.2% in 2002 to 0.5% in 2005. However, none of the countries that have benefited most from high oil prices have made this kind of stabilization effort.

Monetary policies in most countries have also been managed conservatively. The inflation targets which some of the region's largest economies have adopted in recent years, have been successful in reducing inflation, and have meant smaller trade-offs in terms of growth. Appreciating exchange rates have also helped keep prices in check.

Several governments in the region have taken advantage of favorable international financial conditions to pre-finance future debt payments, anticipating the risks that elections or other events could bring. Some countries have managed to extend the term of their obligations and re-

duce the proportion of their debts in foreign currency, thus mitigating the risks from financing or terms of trade shocks.

MEDIUM-TERM RISKS

Although, for 2006 the consensus in the markets suggests a repeat of 4 to 4.5% growth in Latin America and the Caribbean, the region faces several medium-term risks. On the external front, these include: 1) a possible slowing of international trade—due to a deceleration in key markets like the U.S., the rise of protectionist pressures, and a potential failure of the Doha round; 2) the instability of oil prices, which variously affects oil-exporting and oil-importing countries in the region; 3) and a rise in global interest rates.

On the domestic front, as well, several economic risks rear their heads on the horizon. 1) Levels of indebtedness continue to be high for the region to weather the typical external and domestic shocks of the past; 2) The political and operational independence of Central Banks, which has been instrumental for controlling inflation, could come under strain in certain countries; and 3) Many vulnerabilities remain in the banking systems including high levels of financial dollarization, the high concentration of financial system assets in government paper, and the inadequate regulation of derivatives and other risk transfer instruments.

THE POLITICAL QUESTION

The most evident source of risk on the domestic front will be the election cycle of the next twelve months in a dozen or so countries of the region. Not only are election cycles closely coinciding in time, but the range of ideological and policy options on offer to voters has expanded significantly. Although this should be seen as a sign of the vigor of democracy in the region—one should not forget that only 25 years ago most of the people in Latin America and the Caribbean were living under military governments—past experiences show, that the months before elections exacerbate the sensitivity of investors and markets, and increase the vulnerability of countries to changes in international conditions.

A key factor in understand [sic] the region's political panorama is to recognize the widespread feeling of disappointment with the results of the reform agenda of the last decade and a half, typically associated with the "Washington Consensus". Although the situation has begun to improve in the last 2-3 years, for nearly a decade millions of ordinary Latin Americans saw wages stagnate, job opportunities decline, and their quality of life deteriorate in a context of intensive, often over-sold reforms. Beyond the academic discussion of whether the reforms were enough or were adequately implemented, public perception turned against traditional, orthodox policies, and the electorate's receptiveness for alternative proposals grew.

It is no surprise then that the current governments of seven countries of the region can be classified as left of center. This number could well

increase with the current wave of presidential elections in 12 countries in as many months. It is important to note that a further switch to the left, if it occurs, will NOT likely imply the abandonment of orthodox macroeconomics or the adoption of populist policies in most countries. Lack of fiscal or monetary discipline has been the exception rather than the rule among the current left-leaning governments, and there is a very strong political reason for this: electorates have severely punished those governments that have allowed inflation to increase. Recent studies by the Research Department of the Bank have shown macroeconomic discipline has paid-off handsomely in political terms.

However, Latin electorates seem more skeptical of pro-market reform policies, most specifically, trade liberalization and privatization. The incumbent party typically lost 15 percent of its share of the vote in presidential elections on account of the average amount of pro-market reforms introduced during its term. More aggressive reformers (say, the governments of Argentina, Bolivia or Peru in the early and mid nineties) may have sacrificed as much as 25 to 30 percent of their share of the vote on account of pro-market reforms. Not surprisingly, structural reforms have stalled in the region since the late nineties and proposals for aggressive pro-market reforms are conspicuously absent in the current electoral campaigns.

This does not imply that the region will move en masse towards the interventionist policies of the past. For one thing, intolerance to pro-market reforms is weakening as recovery has gained momentum. The last round of Latinobarómetro opinion surveys has shown that the percentage of Latin Americans who consider privatizations beneficial for their countries increased from 20% in 2003 to 31% in 2005. More generally, a vast majority of Latin Americans think that the market economy is the only system that can develop their countries. In Colombia, nearly 75% think that way, and in Venezuela, two of every three people think that, with all its defects, there is no better system than a market economy.

THE IDB'S ROLE

It is in this environment of greater ideological ferment and nuance, but also, encouragingly, of greater political maturity, that the IDB must operate to further its twin missions of promoting sustainable economic growth and reducing poverty and furthering social equity in Latin America and the Caribbean. This context demands that we be pragmatic and flexible in our instruments, processes and programs, while remaining firm in terms of the fundamental strategies and characteristics of policy that we consider key to fulfilling our mission for the benefit of the region's inhabitants.

We do not believe that the public debate on the results of the structural reforms of the last decade and a half is a bad thing. To the contrary, we see it as a necessary step in consolidating the achievements of the reform agenda and setting new objectives and priorities, because we recognize

that the effectiveness of economic and social policies crucially depends on the support they receive during the political process of discussion and implementation.

In the end, what will determine the capacity of the region's governments to be successful, and our own relevance, will be their ability and our own to deliver results to the broad Latin American and Caribbean population. In this spirit, we are working to transform the organization of the Bank to make it more nimble, creative and responsive to country needs. At the same time, we have identified a series of areas of key importance to the region in which we will concentrate our efforts in the years ahead.

TRADE

One clear unsung outcome of the Mar del Plata summit—one which was overshadowed by the tumult in the streets—is that there is consensus among the vast majority of the nations in our hemisphere in support of freer trade in the Americas. With a successful Doha round most of the remaining countries would probably follow suit. Indeed, if the U.S. implements FTAs with Panama, Peru, Colombia and Ecuador, as may happen in the next year, we will in effect have trade agreements connecting all the countries in the hemisphere's Pacific rim—from the Bering to the Darwin Straits.

The IDB is fully committed to advancing the hemispheric trade agenda as a key platform for promoting competitiveness, furthering and anchoring reforms, upgrading enabling environments and boosting regional growth. We will not only continue to further the public trade agenda through seminars, lobbying and publications, and support countries with financial resources, technical cooperation and knowledge for the negotiating phase; we will also work with them on "day after" issues such trade capacity building, regulatory reform, customs optimization, and sector adjustment programs, among others. Our work with the DR-CAFTA countries in this respect has been very useful as a model for future trade agreement implementation.

INFRASTRUCTURE

But to realize the full benefits of expanded trade, Latin America and the Caribbean must greatly expand and upgrade their infrastructure base. The IDB estimates that over the next decade, the region will need to invest more than \$80 billion dollars a year in infrastructure. Given fiscal restrictions to public investment in the countries and the magnitude of the needs, we believe these can only be met through joint private and public efforts.

In this area, I believe the Bank has a crucial role to play, especially in projects that eliminate development bottlenecks and have additional complexities because of their transnational nature or environmental and social issues. Some of the most interesting opportunities in the sector—

such as the Southern Cone energy ring—are cross-border in nature. The Bank has much to contribute in large-scale projects of this type, not only because of its substantial track-record in the sector and its experience in addressing social and environmental concerns, but also because as a regional multilateral institution it is uniquely positioned to serve as an interface between governments and enterprises, between countries, and with civil society groups.

THE PRIVATE SECTOR

No development process is sustainable without the private sector, as the engine of investment, innovation, productivity and employment. Empowering the region's private sector and, in particular, drawing the region's numerous small- and medium-sized businesses into global production and distribution networks is crucial for growth and employment in Latin America and the Caribbean. As an MDB, we have to place emphasis on projects that have major development impact and little chance of getting financing through the market.

Our Private Sector strategy has two basic components. First, we are working to better coordinate our different private sector windows—which target everything from micro-entrepreneurs to large corporations—, so we can expand our activity. Currently, Private Sector lending accounts for only 3% of the IDB Group's total portfolio. We want to quickly bring it up near the 10% our charter allows. To accomplish this, we are working to increase lending caps, broaden the mandate in terms of the sectors we can work in, and design new more market-driven instruments and services so that we can meet the needs of our region's businesspeople and entrepreneurs more creatively, in shorter timeframes and with fewer obstacles. For example, we recently did a pioneering transaction in Colombia where the Inter-American Investment Corporation issued bonds in pesos in the local markets worth \$60 million dollars and then lent those pesos to local leasing companies that finance investments in machinery.

Our second area of focus is to redouble our efforts to engage regional governments to improve enabling environments for private enterprise for all players—large and small, domestic and foreign—, by strengthening regulatory stability and transparency and the rule of law as well as bureaucratic accountability, building deeper and more robust financial systems, promoting better and more flexible labor markets, consolidating public-private innovation systems, and reducing the costs and hurdles to business activity.

A SOCIAL AGENDA FOR THE XXIST CENTURY

Given Latin America's particular poverty and inequality challenges, and the threat they pose to democratic governance in the region, we believe the Bank must continue to pay special heed to social policies that enhance opportunity and protect the most vulnerable. Latin America is

the world's most unequal region, with the richest 20% of the population receiving 60% of income, and the poorest quintile, just 3%. Moreover, the region presents dramatic inequalities not only in income, but in terms of educational opportunities and access to health and social services. In this regard, to achieve greater progress in poverty reduction and to bridge these substantial opportunity gaps, we need to combine both a top-down and a bottom-up approach.

From the top-down perspective, the Bank will continue to support and lead the way in efficient and focused public programs that yield results for the region's poor, and provide them with the health, nutrition and educational choice and quality they need to be able to effectively participate in the opportunities of the globalized economy. In this respect, the experience of the last few years in Conditional Cash Transfers is extremely encouraging. These programs, which have been successfully implemented in Mexico, Brazil, Colombia and a variety of other countries in the region, provide for small monthly transfers of cash to poor families (particularly single mothers) to attempt to break the cycle of poverty. These transfers are conditional to the families' having their children vaccinated and their health monitored, and keeping them in school. Today, CCTs, as they are called, have more than 50 million beneficiaries in the region, and independent assessments have shown that their impact on poverty and human development is substantial.

While we continue to support these programs, and others in education and health-care that are cost-effective, promote accountability and quality of service, exploit public-private synergies, and focus on the poor, we are also working to launch bottom-up initiatives that will empower the poor to become active participants in the region's development. Nutrition, adequate health-care and basic education, are necessary, but not sufficient, conditions for emerging from poverty. We believe we need to create a stronger link between improvements in human capital and employment and entrepreneurship opportunities.

One mechanism is a push for what we call financial democracy. The simple truth is that the financial systems of Latin American and Caribbean countries are basically irrelevant to the lives of the majority of their populations. The resulting "intermediation gap" is reflected in shallow financial markets, which limit broad based economic growth and help to perpetuate inequality across the Region. As a result, seven out of every ten persons, and almost nine out of every ten businesses, have essentially no access to formal financial institutions, or their products.

One way to reach this majority is by leveraging the large flows of remittances (\$55 billion dollars this year) to generate credit, investment and employment. Currently, less than 10% of remittance recipients are estimated to have access to savings accounts, loans, or other basic financial services. Once remittance senders and recipients have bank accounts, they can have access to credit for housing, education, starting a business, etc., thus providing a very powerful development tool to multiply eco-

conomic impact for millions of families. We recently approved our first “re-mittances for housing” loan in Mexico.

Another such strategy is promoting micro-finance. Micro-finance as a sustainable and profitable business proposition begun in Latin America with IDB support more than 30 years ago; for the last 10 years, we have been providing various forms of finance, including equity, to promote the integration of microfinance into the broader financial sector. The IDB did this by funding start-up financial intermediaries, and by transforming NGO’s into for-profit, regulated entities. This industry now includes over 80 specialized and profitable microfinance institutions with an estimated 4 million clients and a US\$4 billion portfolio.

Yet, these institutions are meeting only a fraction of total demand. We will continue to work with governments to improve enabling environments, and private and civil society partners to spread micro-loans to the regions’ millions of budding entrepreneurs.

CONCLUSION

I think I have exhausted my time and probably also your patience, so I will leave you with these thoughts. Before this, however, I want to stress that we at the Bank see tremendous opportunity beckoning in Latin America and the Caribbean and are bullish on the region’s future. The fundamentals are right, economic management and institutionality have improved, democracy—with the diversity it allows—is increasingly consolidated, and the reforms and investments of the past decade are beginning to bear fruit. I invite you to take a fresh look at the region and help us realize its full potential.

Articles

