World Geography
IMF and Globalization

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Directions: Read the speech below by Horst Köhler, the managing director of the IMF and summarize what the IMF is doing to help Central America and what is the plan for improving Central America

Seizing the Opportunities of Globalization in Central America

Horst Köhler
Second Annual Round Table on Central America
San Salvador, July 21, 2003

It is a great pleasure to be here in San Salvador—my second visit to Central America as Managing Director—and meet such a distinguished group of leaders from the region. I would like to thank the Salvadoran authorities and the Central American Monetary Council for hosting this regional conference, which provides a valuable opportunity to discuss the key challenges facing Central America.

Our meeting takes place against the background of still considerable uncertainty for the world economy. But, overall, the balance of risks has improved. In the United States, there is substantial stimulus in the pipeline and forward-looking indicators have strengthened. In Europe and Japan, while there are as yet few firm indications of an imminent recovery, I am encouraged by the new momentum for much-needed structural reform. Therefore, I expect a gradual recovery of the global economy in the second half of this year, with a strengthening of global growth to about 4 percent in 2004. This will also create a better external environment for the strengthening of growth in Central America.

At the crossroads of the hemisphere, Central America is well placed to seize the opportunities of globalization. Historical experience has shown that with the right policies, small open economies can reap great benefits from tapping into the global market place. The successes of Singapore or South Korea, for example, which saw per capita income rise ten-fold in the second half of the 20th century, provide ample evidence of the opportunity that globalization offers to countries with limited own resources and small domestic markets. Globalization also carries risks, as evidenced in the severe financial crises of the 1990s. To contain those risks, and ensure that the benefits of globalization are widely shared, requires sound policies and, especially, strong institutions and governance in each country.

- The past decade has witnessed historic changes in Central America. Most significant, perhaps, has been the strengthening of democracy after many years of conflict. Many countries in the region have embarked on a path of economic reforms. Over the past decade, stronger macroeconomic policies and a growing emphasis on trade liberalization and export-led growth, have brought some important achievements. In particular, growth in the 1990s turned positive, and average per capita incomes rose by 2½ percent per year. Not enough, but a striking contrast to the previous decade's decline.

However, with the exception of Costa Rica, poverty rates remain high, with social indicators below the average for Latin America. External shocks, such as Hurricane Mitch, the sharp fall in world coffee prices, and the decline in tourism since the September 11, 2001 attacks, have placed several economies in the region under severe strain. But many countries also found it difficult to sustain strong economic policies in the face of a weak domestic consensus and resistance from various interest groups.

Looking ahead, sustained growth and poverty reduction in Central America will require perseverance on three fronts.First, making the economies more "crisis proof", by boosting their resistance to shocks and consolidating macroeconomic stability. Second, pursuing structural reforms to raise productivity and strengthen institutions and good governance. And third, improving social equity to maintain consensus on the policy framework and achieve lasting poverty reduction.

Many countries in the region have already taken important steps to this end. I applaud the strong reform agenda being implemented by President Bolan_os in Nicaragua, and the efforts of the Guatemalan authorities to maintain a sound economic framework during the forthcoming elections. El Salvador has achieved investment grade rating—the only country in the region so far—and Costa Rica, Honduras, and Panama are also strengthening their commitment to growth-enhancing reforms tailored to their individual circumstances. What is required now is to sustain and deepen these efforts so that Central America can tap its potential for growth and make decisive progress in reducing poverty.

Making economies more crisis proof requires more robust fundamentals and greater scope to absorb shocks. Further progress is needed, in particular, in two key areas:

- First, ensuring sustainable public debt dynamics. Better control and efficiency of spending is important. But infrastructure and social needs remain high, and there are limits to the scope for further cutting expenditure. Tax reform is, therefore, crucial and, given the generally low share of revenues in GDP, there remains much scope to broaden the tax base and reduce evasion. Improved debt management is also important, especially of dollar-denominated or -linked debt which has proven to be a major vulnerability in many countries.
- Second, strengthening domestic financial sectors. There is an urgent need to move away from weak supervision and forbearance, improve regulatory frameworks, strengthen governance, and contain informal dollarization and its risks-efforts that require strong political support. This is an area in which the IMF has been increasingly active in recent years, including in Central America, through its Financial Sector Assessment Program, implemented jointly with the World Bank.

The choice of exchange rate regime is especially important in this context. Pegs can be helpful in anchoring expectations, and official dollarization can enhance confidence as shown in Panama and El Salvador—but these regimes place great demands on the policy framework to ensure its consistency with this choice. In many other countries in the region, increased exchange rate flexibility has played a useful role as an economic "shock absorber" and by discouraging the build-up of risky foreign currency exposure.

Sustained growth will require structural reforms and strengthening of institutions. There is no template of institutions that works in every country: national traditions will dictate individual solutions. But empirical evidence points to a clear link between the quality of institutions and economic growth. Protecting property rights and the rule of law, combating corruption, and sound regulation of markets are crucial elements of a well-functioning market economy. They are also critical in attracting high-quality foreign investment.

Stronger, more competitive, and rapidly growing economies will greatly facilitate the pressing task of reducing poverty. But growth is not enough; the poor and disadvantaged also need targeted reforms and measures to help them benefit from growth. The agenda will vary from country to country, but experience suggests that programs to further reduce adult illiteracy, enhance rural development, and establish well-targeted social safety nets are crucial to combining fiscal responsibility with progress toward social goals. And combating corruption will yield significant benefits for economic growth by boosting investor confidence, but will also address social equity issues directly, as it is small businesses and the poor who often bear the brunt of the burden of corruption.

Trade can spur faster growth and poverty alleviation. A major responsibility lies with the advanced economies to reduce trade-distorting subsidies and improve market access for developing country exports. I understand that welcome progress is being made toward a regional free trade arrangement with the United States, which can clearly be beneficial for Central America. This could also stimulate greater regional cooperation, including regional institution building. Improved regional market access should not, however, detract from further decisive progress in multilateral trade liberalization under the Doha Round. I hope that the recent agreement within the European Union to reform its Common Agricultural Policy will give new impetus to negotiations in this area. In September, the World Trade Organization will hold its Ministerial Meeting in Cancún. This will be the occasion for the advanced economies to follow up their pledge with action.

At the same time, developing countries can strengthen their growth prospects by further streamlining their own trade policies. Although Central American countries are already fairly open to trade, there are still many trade barriers that impair competition. There is also room to lower further and remove exemptions to the region's common tariffs.

Regional cooperation can enhance the growth potential of individual countries. There are many areas where joining your efforts in this region can yield important benefits, such as collaborating on cross-border infrastructure projects, and harmonizing rules and standards in goods, labor, and financial markets. And in particular, in Central America's increasingly integrated financial markets, it must be a priority to build capacity for the consolidated supervision of financial groups. In this context, the Central American Monetary Council should have a key role to play in coordinating regional efforts to strengthen the financial sector. This will require closer coordination between national supervisory agencies who serve as both home and host supervisors to ensure that banks and financial groups do not avoid adequate scrutiny by shifting activities between various national jurisdictions. I, therefore, strongly welcome this conference, as part of an effort to strengthen the regional dialogue on macroeconomic and financial policies, and we at the IMF look forward to contributing to this effort as we enhance the regional perspective in our work on Central America.

The IMF remains fully engaged in assisting Central America in its quest for faster sustained growth and rising living standards for all. In this partnership, the IMF stands ready to support your efforts, and I encourage you to develop further your own regional mechanisms for policy dialogue, exchange of experiences, and peer review. How can the IMF be most helpful in these efforts?

- With emphasis on crisis prevention, we have increasingly focused our advice on making economies more resistant to shocks. In addition to macroeconomic policies, this has involved comprehensive efforts to strengthen financial sectors and their supervision. It has also included work to improve debt and foreign reserve management, transparency in policy making, and the observance of international standards and codes, such as on the dissemination of internationally comparable economic statistics. And we are enhancing the regional perspective in our work, to catalyze the exchange of cross-country experiences, including through conferences such as this one
- To help strengthen institutions, we are enhancing our technical assistance. Central America has made consistent good use of our services in this area, and I am pleased to announce that additional financing will allow us to increase significantly our technical assistance to the region.
- And finally, we are, as you know, actively engaged with financial arrangements in several countries in the region. Here, too, our support must be tailored to the individual circumstances of each country, and be based on a strong domestic consensus in favor of the needed reforms. This is, indeed, the spirit that pervades our program work with countries in such diverse circumstances as Nicaragua, Guatemala, and the Dominican Republic.

In conclusion, integration in the global economy carries great potential, also for Central America. I am optimistic that strong policies and reforms and strengthened regional and international cooperation will allow you to seize this potential and share fully in the benefits of globalization. In this endeavor, the IMF stands ready to assist you.

Thought Question:

1. How is the IMF already assisting Central America?

2. How does the IMF intend to continue helping Central America in the future?