Inter-American Development Bank
Inter-American Investment Corporation

**ADDRESS TO THE XXXI ANNUAL MEETING OF THE BOARD OF GOVERNORS**

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The 1980s are now behind us and the decade has closed with profound historical innovations that will strongly influence the world economy in the years ahead. Major changes in the environment in which developed and developing economies interact have been set in motion: economic integration in Europe; political and economic reforms in the centrally planned economies; and the liberalization and deregulation of financial markets throughout the industrial world.

Taken together, these trends will increase the global dimension of markets for goods and services and will strengthen interdependencies across geographic areas and productive sectors; and they may lead to faster non-inflationary growth in the world at large. In Latin American countries they will provide challenges and opportunities. Challenges will come from the increasing competition to attract foreign investment; opportunities from the continuation of the present phase of world economic expansion and the opening of new markets.

In order to keep up with the pace of change and benefit fully from favourable economic developments, the countries of Latin America and the Caribbean will need to integrate more effectively their economic structures and policies with those of the rest of the world. To yield to the temptation of pursuing unilateral approaches or postponing necessary adjustments would be self-defeating.

In the region the economic picture remains worrisome. Growth was still very low in 1989; according to the latest estimates, output increased by only about 1 per cent and in per capita terms it decreased. There continues to be a substantial net transfer of resources abroad. The total external debt in relation to GDP was about unchanged, although the debt to export ratio declined for the third consecutive year.

Inflation accelerated further. The region average climbed to an unprecedented high of 1,000 per cent during 1989. Hyperinflation affected several countries; price increases accelerated to 4,000 per cent in Argentina, to 3,000 per cent in Peru and to 1,500 per cent in Brazil, while in twelve other countries the rate ranged from 10 to 40 per cent. In our opinion, inflation is the most alarming problem that Latin America has to face. Its level and persistence seriously distort the efficient allocation of resources and discourage capital inflows. Not surprisingly, in this uncertain environment investment continues to remain low and the repatriation of flight capital has not yet materialized.

Despite the admission that the region is still facing serious economic problems, we should not fail to recognize that positive developments have occurred. Strengthened by the proposals of Secretary Brady, the debt strategy is working, although at a pace some may consider too slow. Its main contribution have been, first, to provide a clear incentive for adopting and sustaining the required adjustment effort and, second, to bridge the confidence gap that has discouraged both domestic and foreign investment. The negotiations between debtors and creditors that are under way or have been concluded show the benefits that can derive in terms of improved financial and economic conditions. Debt reduction and capital inflows are definitely part of the solution, but they are by no means the only component and a major contribution has to be made within the debtor countries themselves.

Far-reaching adjustment programs are now under way in several countries, including some of the largest debtors, and results are starting to show. Following the implementation of appropriate stabilization policies in 1989, growth was buoyant in Chile (8.5%) and Costa Rica (4.1 %); inflation rates have been falling in Mexico, Bolivia, the Dominican Republic and more recently in Venezuela; Mexico has been recording a substantial increase in exports and strong inflows of foreign direct investment.

Latin America's financial and economic problems however have only been dented by the progress we have observed; nevertheless what is important, and encouraging, is the increasing commitment of governments to take the necessary policy decisions. In this respect, priority should be given to tackling macroeconomic imbalances (above all fiscal and monetary disequilibria), of which inflation is the most visible symptom. Addressing the underlying causes of inflation in most cases requires significant changes in the tax system and the financial sector to expand revenues, reduce government outlays and avoid the monetization of deficits. Further, in order to raise the level of sustainable development, structural impediments to investment, exports and growth will have to be removed; in so doing, Latin American countries should be encouraged by the success of outward-oriented policies adopted in the recent past by quite a number of developing nations around the globe.

Developing countries should be reassured that if needed adjustment efforts are undertaken, international support will be forthcoming. The industrial countries and the international financial institutions will continue to play their role in maintaining sound policies to sustain non-inflationary growth in the world economy and provide adequate financing to the developing countries. In this connection, stronger fiscal discipline is needed in industrial countries to free resources from the public sector and accommodate the increased investment demand in the world at large, thereby relieving the burden placed on monetary policy and avoiding pressure on interest rates.

In the nineties, greater competition for world savings from Eastern Europe and from the industrial economies will make it even more important for Latin America to use resources efficiently. Gone are the years of easy financing that masked inefficient investments and resources allocation. A sound macroeconomic and structural environment is the essential prerequisite for maintaining a satisfactory level of non-inflationary development. This is the lesson to be learned from the eighties and if it is, at least in this respect they will not have been a "lost decade" for Latin America.

In this perspective the Inter-American Development Bank and the other international financial institutions have a crucial function to play in supporting macroeconomic adjustment and policy reform where needed and in providing resources for investment that raise productive capacity, employment and exports. We therefore wish to reiterate the Italian Government's full support of the Bank's activity and underscore the importance that Italy attaches to the development and prosperity of the region. In this regard we believe that the non-regional members' role in the Bank should be reinforced with respect to financing, management and policy decision-making, in line with the principles supported by the membership at large during the last annual meeting.

Latin America's needs are many and varied and the IDB will have to endeavour to respond to members' different requirements effectively and without running the risk of dispersing its valuable resources. Thus, in pursuing its overall goals, the IDB should continue to concentrate on financing investment projects designed to improve the economic and social infrastructure. This is the area in which the Bank enjoys a comparative advantage due to its knowledge of the region and its experience in evaluating projects. Development of productive and social infrastructure will help sustain adjustment efforts by catalyzing private capital flows and reducing social costs.

Efforts should be made both to increase the quantity and to improve the quality of projects. The Bank needs to strengthen its ability to identify economic and social bottlenecks hampering the development process. In this connection we believe that closer cooperation with domestic governments, at both the central and local levels, should be sought through more effective use of the network of field representatives. The Plans and Programs department will also need to play a greater role in this respect.

In the domain of productive infrastructure there is a great need for new and replacement investment in the energy and telecommunications sectors. The tourist sector also offers considerable potential for the region's development. In the area of social infrastructure, we attach great importance to poverty alleviation through projects in the fields of education and health.

The environment will also have to be given increasing attention by the international development institutions. In this respect we welcome the creation of a special division within the IDB, as well as the recent proposal of the World Bank to establish a global environmental facility which is receiving wide support from the donor community. The environmental impact of the investment projects financed by the IDB should be thoroughly assessed. To balance environmental issues with economic development in the region, the IDB should cooperate closely with local authorities when promoting conservation projects and educational campaigns. Initiatives by the IDB and the IBRD in this field should be carefully coordinated in order to maximize their effectiveness.

The means by which the IDB and other development institutions can help the parties concerned in designing and executing "debt for nature" swaps need to be explored. We consider such operations to be a viable way of achieving both social and economic objectives that will benefit the local population, the country's economy and the international community at large. To be effective, debt-nature swaps must provide additional resources for debt reduction and environmental purposes, and be accompanied by the development of efficient environmental institutions in the debtor countries in order to manage the conservation program over time. Legal issues pertaining to sovereign rights also will have to be addressed in designing this type of operation. The Bank could provide valuable assistance in all these areas.

The IDB should enhance the support it gives to the development of the private sector. In particular, we wish to underline the provision of technical assistance for privatization programs and the development of capital and credit markets. The role of the Bank in this domain should not be seen independently of the activities of the newly-created Inter-American Investment Corporation. In shaping a clear strategy for the Corporation, management and shareholders should abide to the IIC mandate of serving small and medium size companies and should give preference to equity investment over loan operations. To find its way the IIC will have to be innovative, determined, and cost conscious. Shareholders must be innovative as well: one of their tasks would be to ensure that the activities of the IIC are compatible with those of the IFC and that they are self-reinforcing. In particular the 51 percent local investment requirement which hampers the flow of foreign equity to Latin America should be reconsidered.

We take note with satisfaction of the first operations undertaken by the Corporation in 1989. While we do not expect the IIC to be a major player in its first years of activity, we are confident that in due course it will make a valuable contribution to the expansion of private enterprises.

At last year's meeting we welcomed the introduction of Sector Loans and we know that this type of lending will start soon. We wish, however, to reiterate that if these loans are to be effective, beneficiary countries will have to be pursuing adequate macroeconomic policies and accept an appropriate degree of conditionality. Furthermore, the IDB should work closely with the World Bank to identify and develop sector loans to be financed jointly.

To achieve its ambitious lending targets and respond to the legitimate requirements of its members, the Bank must be endowed with a strong and efficient organizational structure, among other things to build up its pipeline of projects. Efforts are under way to reshape the structure of the Bank: a Special Employment Termination Program is being completed; several new divisions have been created. These are indeed significant steps forward for which President Iglesias, the management and the staff have to be commended. However, the task of reorganization is not completed yet and the drive to achieve the Bank's full operative capacity as soon as possible has to be maintained.

We attach great importance to personnel policy. We believe that staff and management are the Bank's most valuable assets. The strongest possible effort should be made to recruit top quality employees and to match their abilities with job requirements. In view of the increasing demand on the Bank's functions and the need to keep the size of the staff in check, consideration should be given to extending the use of external consultants and cooperation agreements when special technical expertise is required and flexibility is necessary.

Finally, we need to keep the arrears problem under constant scrutiny. Although confined to very few countries, arrears to the IDB have been increasing recently and amounted to over 400 million dollars at the beginning of the year. This should be a matter of great concern to all the Governments participating in the Bank's capital. An appropriate policy should be formulated and implemented before the problem becomes entrenched and more difficult to deal with. Measures should be examined to help members in arrears to become current with the institution and to prevent new cases from arising.

To conclude, the challenges facing Latin America are huge but the increasing commitment to sound growth-oriented adjustment policies that we have witnessed lately is most encouraging. Fostering and supporting such adjustment efforts through the pursuit of its statutory objectives and providing intellectual leadership as a partner in development are the key contributions that the IDB can make to a durable solution of the region's most urgent problems.