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Speech by Rodrigo de Rato,
Managing Director of
the International Monetary Fund,

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1. Thank you very much. It is a great pleasure to participate in this conference. I hope it will be the first of many on this important subject. I want to begin by thanking President Arias again for his inspiring speech last night and the government of Costa Rica for hosting this conference. I would also like to give a special welcome to our guests from the private sector, whose presence is essential to the success of the conference. I look forward to hearing your views later this morning.

2. We are here to talk about investment in Central America—obstacles to investment and policies to remove those obstacles—and I'll say something about these in a few minutes. But it's useful to step back and ask why investment is important, what it can do for countries and for people.

3. We live in a world of globalization. The pace of technological change is staggering. The extent and speed with which innovations in one country cross borders through exchanges of goods, capital, and ideas is unprecedented. We cannot stop this process. President Arias wisely said in a speech in New York last December that the dilemma that developing nations face is that "if we cannot export more and more goods, we will end up exporting more and more people." Nor should we want to stop globalization: it carries with it the prospect of improving the lives of people in all countries. What we should try to do is to manage globalization and make it work for citizens. The task for governments and for institutions like the International Monetary Fund is to try to maximize its benefits and minimize its costs and risks.

4. Chief among the opportunities that globalization gives rise to is the prospect of higher growth and higher living standards. By promoting free trade, Central American countries can deploy to the maximum extent possible the law of comparative advantage,

leading to higher incomes for their citizens. By encouraging financial flows, countries in the region can make use of savings from outside it, making possible more investment. And by encouraging foreign direct investment, Central America can gain access to technology, knowledge, and managerial expertise from abroad, and trigger vertical integration and the development of supply chains. One important goal should be to make the region as a whole attractive to investors. Foreign companies are more likely to invest in Costa Rica, with its population of less than 5 million, if doing so will give them a foothold in the region, with its population of over 25 million.

5. One way in which the nations of Central America can take advantage of the opportunities afforded by globalization is through regional integration and greater openness to trade and investment. Indeed, around the world, from Asia to the Maghreb, interest in regional integration is growing. The CAFTA initiative is one aspect of this, and one of its key benefits is higher investment. To see what can be achieved, you only need to look a little to the north. In the decade after the signing of the NAFTA agreement, foreign investment in Mexico rose fourfold, from US$12 billion during 1991-93 to roughly US$54 billion in the period 2000-02.

6. Measures to encourage investment are especially important in the Americas, as this is an area where Latin America has long been at a disadvantage compared to other regions. During the period 2003-2006, real investment was only about 20 percent of GDP in Latin America, compared to almost 30 percent of GDP in Eastern Europe and Central Asia and almost 35 percent of GDP in emerging Asia. Raising the investment ratio is only a part of the solution. Raising productivity, which has also been chronically low in Latin America, is also important. But action on both together can produce impressive results. For example, we have estimated that a doubling of per capita income in Latin America could be achieved by 2025 if average investment was raised to 24 percent of GDP and productivity growth was 2 percent a year.

7. What then are some of the policies necessary to support foreign and domestic investment, and promote growth? I especially look forward to hearing the views of private sector participants on this question in the course of this conference. But let me give you a few thoughts based on the Fund's experience in countries around the world.

8. For all countries in the region, maintaining macroeconomic stability is clearly an important part of the growth and investment equation. Most countries in Central America are doing well. Average growth was over five percent last year, which is above the level of recent years. Inflation is in single digits in most countries in the region. And Central American countries have achieved these results notwithstanding a significant deterioration in the terms of trade. Nevertheless, there are some caution flags. Real primary spending increased by over 9 percent on average in Central America in 2006, and current expenditure accounted for most of this rise. Capital investment remains

relatively low in the region. More needs to be done to reduce financial sector risks, especially from off-shore centers. And Central America remains vulnerable to external shocks, especially a downturn in the United States, given the high share of the region's exports that go to the United States.

9. Macroeconomic stability is essential if investment is to grow. Savers must be confident that they will not lose out due to inflationary surges. And investors must be confident that that there will not be crises that produce sudden reversals of policy. A continued political commitment to prudent fiscal policy and control of inflation is therefore the first condition for increasing investment and promoting sustainable growth.

10. Another important element in investment decisions is the cost of doing business. The Latin America and Caribbean region ranks significantly worse than either the OECD or Asia in terms of the cost of starting a business, dealing with licenses, and enforcing contracts. Lowering barriers to entry into business and improving regulatory frameworks would both promote investment and stimulate growth.

11. It is also important to have a stable and predictable legal framework. Since many investments only pay off over the long term, it can be costly to investors if the rules of the game are changed frequently. Stability of contracts and a well-designed dispute resolution process are likely to be particularly important for investors.

12. Financial integration can also help to establish a broader investment market—including for some of the remittances from the Central American community in the United States, which amount to an extraordinary 10-15 percent of GDP. Central America is already making great progress in financial integration. Financial institutions that originally focused on their home markets are now providing services throughout Central America. Governing institutions must step up their coordination of regulation and supervision to reflect these developments. Regional institutions such as the Central American Monetary Council and the Central American Council of Financial Sector Superintendents can play important roles in sharing information, harmonizing regulations, and coordinating policies.

13. Coordination is also important in tax policy. Governments of the region are well aware of this, and, I'm glad to note, are making headway in a number of important areas, including double taxation and transfer pricing. Another important issue is simplifying and harmonizing tax incentives across the region. While I understand that tax incentives appear appealing, their effectiveness is subject to debate and they can easily lead to costly tax competition—a particular concern in this region where the need to boost education and infrastructure is great, tax revenue in proportion to GDP is low, and, as is recognized by all, maintaining strong public finances is vital.

14. Before closing, I should mention one special set of policies which have the potential to increase investment and growth, and which also address directly issues of poverty and inequality. For example, investment in human capital through improved primary and secondary education helps develop a skilled labor force, capable of responding to shifting demand for labor. We all know that this would be welcomed by investors. But it also promotes equality of opportunity, and lifts people out of poverty. Labor market reform can also help promote a skilled labor force. And it can produce the additional benefit of bringing the poor into the formal system of employment, thus improving their legal benefits and protections. Better access to credit and financial services promotes saving and investment and also offers opportunities to the poor.

15. Some countries in the region have already taken the lead in measures which deepen human capital and also target poverty. These include innovative conditional cash transfer programs which encourage poor families to make specific investments in their children’s health and education. Actions like these are conducive to investment and growth. But they are also very important in their own right. It is essential that the benefits of investment and growth are shared widely and, in particular, reach the poorest people.

16. In a broader sense, the Fund and the wider international community face a challenge similar to that faced by governments in Central America. The world is experiencing a wave of economic and financial globalization which has many benefits. But not everyone is enjoying those benefits. We need to come up with a response to those who have lost out from globalization and to those it has not yet reached. Indeed, a good part of the work we are doing to reform the IMF is designed to meet this goal. For example, we are refining our work on low-income countries, to ensure that we are focused on issues where we can make the greatest contribution to help these countries raise growth and reduce poverty. And we are examining the tools we have to combat financial crises, which have been so damaging to Latin American economies in the past.

17. We cannot solve all of the problems of globalization at this conference. But we can make an important contribution to policies that have the potential to deliver some of its benefits. So now, I look forward to hearing your views, and once again, I thank our hosts, and President Arias.

18. Thank you very much.