Boosting Inclusive Growth in Central America

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Against the background of moderate global growth and increasing risks, the IMF and the Central Bank of Guatemala hosted the XIV Regional Conference for Central America, Panama, and the Dominican Republic to discuss policy options to achieve stronger, sustainable growth and deliver a faster reduction in poverty and inequality across the region.

Regional economies continue to benefit from the recovering U.S. economy, low oil prices, and still favorable international financial conditions, notably low interest rates. These positive conditions offer a unique opportunity to remove obstacles for investment and advance social progress.

In light of this, we would like to share our main takeaways of the conference.

Strengthening prospects for growth

Our most recent projections anticipate that the region will continue to grow at some 4 percent per year for 2016–17. While this pace is stronger than in the rest of Latin America, it is not enough to bring down poverty and inequality more rapidly (see Chart 1). Hence, conference participants noted that the region needs to achieve faster and more durable growth. To this end, progress in two fronts will be key.

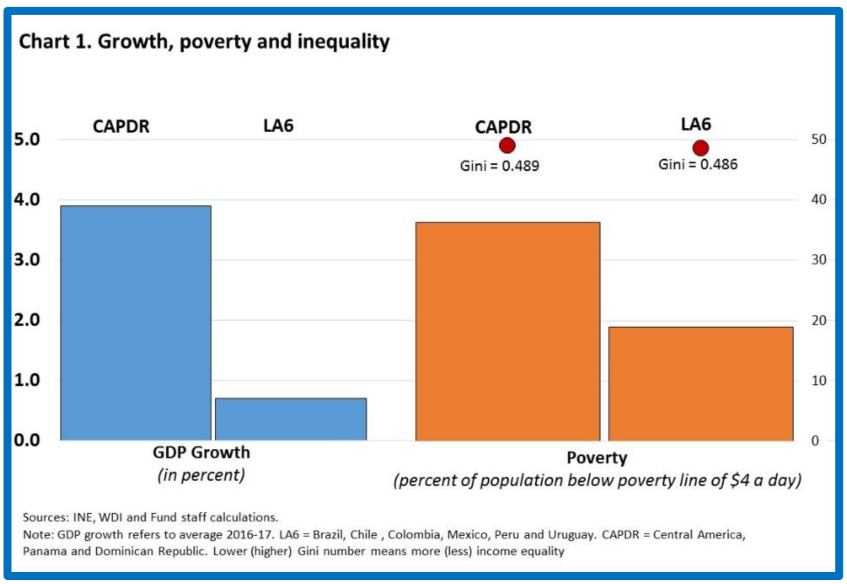
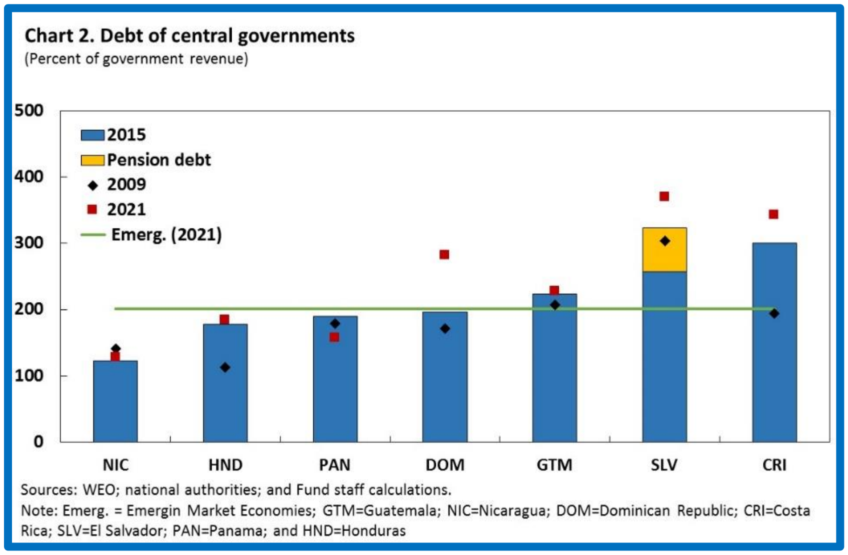


Chart 1. Growth, poverty and inequality

Sources: INE, WDI and Fund staff calculations.
Note: GDP growth refers to average 2016-17. LA6 = Brazil, Chile , Colombia, Mexico, Peru and Uruguay. CAPDR = Central America, Panama and Dominican Republic. Lower (higher) Gini number means more (less) income equality

First, stronger policies are needed to make growth more resilient to changing economic conditions. A key challenge in most countries is to reduce public debt (see Chart 2) and rebuild space for countercyclical fiscal responses (policies that act against the direction of the business cycle). Once the fiscal situation has been corrected, budgetary health should be protected with well-designed fiscal rules. Greater exchange rate flexibility will help protect



output and jobs from adverse external shocks, while monetary policy should remain vigilant to stem possible emerging price pressures and strengthen its transmission to the economy. With sounder banks—that rely less on short-term foreign borrowing, curtail lending in foreign exchange to unprotected borrowers, and follow strong anti-money laundering practices—the mobilization of savings toward investment will be made more secure, even if global capital markets were to experience bouts of volatility. Overall, further consolidation of macroeconomic and financial stability will improve prospects for investment and job creation.

Second, since the regional economies are operating near capacity, countries should raise investment, human capital, and productivity to expand potential growth. Higher tax revenue and more efficient public spending are key to upgrade infrastructure, improve the quality of education, and strengthen domestic security. Tackling corruption and more generally improving the business climate, not least by streamlining regulations and reducing barriers to entry, are crucial to foster greater private investment.

Focusing on key reforms

In light of the recent increase in protectionist sentiment in advanced economies and associated prospects of sluggish global trade, conference participants emphasized the importance of reforms that could ignite new sources of growth and reduce social disparities.

Financial inclusion offers opportunities for growth and reduction of social inequality by helping raise the incomes of the most vulnerable. Indeed, the region is making important strides in expanding the access of basic financial services. This helps lower-income families to save more easily or borrow for education and health care, and small companies are now able to invest and grow. The next steps are to lower access costs further, improve financial education, and bring more technology into the banking network, while preserving financial stability.

Based on the integration experience of Mexico within the North American Free Trade Agreement and of Spain with the European Union, participants foresaw considerable opportunities for growth from increased economic integration within the region and with the global economy. Trade within Central America is very low compared to more dynamic regions in the world. Therefore, broadening the regional market and stepping up participation in global production chains will help expand exports, investment, and jobs across the region. Equally important, trade policies should ensure that the benefits of integration are fairly distributed within society.

A well-designed strategy for infrastructure development could also stimulate growth, reduce poverty, and support regional integration. Most countries in the region suffer from poor quality of roads, ports, airports, energy production, and customs services. Hence, bringing the quality of infrastructure to levels seen in faster-growing emerging economies would greatly reduce production costs and facilitate effective inclusion of lower-income producers into the economy. But better infrastructure requires reforms to create fiscal space for public investment and foster private sector involvement, without creating risks to the budget.

All in all, Central America, Panama, and the Dominican Republic could do more to improve social outcomes. Taking advantage of the positive economic outlook, the region should decisively redirect policies to address social inequality gaps and tackle supply-side constraints that hinder growth. Over the years, the conference has shared important policy lessons for the region and remains a vital forum for policy discussion within the region and with the IMF.

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