Remarks by

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It is with much pleasure that I speak with you this morning. This conference on the Changing Role of Central Banks in Latin America brings me together with many old friends. I have spent a good deal of my professional career both as a foreign service officer and commercial banker living and working in the countries whose central bank presidents are with us today. Over many years, I have had the chance to observe change in Latin America but I am certain that I have witnessed no changes more constructive for the future of Latin America than the striking transformations that have characterized much of the region during the past several years.

Today, for the first time in Latin America's history, democratically elected governments are in place in virtually every country. These governments have been willing to undertake reforms that were hardly imaginable a scant decade ago. They have opened their economies to foreign trade and capital in the belief that the closed, state-controlled ways of doing business in the past were no longer working to their advantage. They have sought to revitalize their markets by such means as reducing subsidies and selling to the private sector enterprises that had become inefficient and costly to manage, even when some of these enterprises were in sectors traditionally preserved for the state. And, they have tried to reverse years of weak economic performance or stagnation by putting in place policies to stimulate domestic saving and investment.

In short, economic reform has become the order of the day throughout much of Latin America. The results have been truly impressive.

One major consequence of this reform effort has been the resumption of growth in most of the region. In Chile, growth has been particularly strong, largely reflecting increased exports and private investment. Growth in Mexico and Venezuela also has been quite strong in the past few years, although it has slowed noticeably this year--in Mexico, largely because of fiscal restraint and high real interest rates, and in Venezuela, as the fiscal situation has worsened and the political climate has become unsettled.

Efforts to control inflation, reduce budget deficits, increase private investment, and lower barriers to foreign trade have been the keys to renewed growth and improved economic performance throughout the region. With some exceptions, notably Brazil where political uncertainty has clouded the policy outlook, inflation has substantially moderated over the past several years, although its levels generally remain higher than those prevailing in industrial countries.

Mexico's pursuit of tight monetary policy and pact with the unions and business sector to contain wage and price increases have contributed to a decline in its inflation from a peak of 160 percent in 1987 to roughly 12 percent last year. This year, inflation may fall to single-digits for the first time in nearly two decades. After bouts with hyperinflation in 1989 and 1990, Argentina was able to lower its inflation rate to 18 percent last year, following the decision of the government in early 1991 to peg the currency, eliminate the fiscal deficit, and prohibit the indexing of contracts.

Notable among the results of the reform effort during the past several years have been significant reductions in fiscal deficits, as many governments throughout the region have acted deliberately and aggressively to limit the public sector's role in the economy. Widespread improvements in the fiscal balance have been achieved by such measures as reducing subsidies, cutting public sector spending, improving tax collection, widening the tax base, and privatizing state-owned enterprises whose inefficiencies entailed substantial transfer payments. The reductions in fiscal deficits that these measures made possible have helped finance increased capital formation throughout the region. Some countries, including Argentina, Chile, and Mexico even ran small surpluses in their fiscal accounts last year.

Throughout Latin America, stabilization efforts have been complemented by structural reforms as well. In addition to the successful implementation of privatization programs and policies to streamline and improve the efficiency of tax systems, there has also been significant trade and exchange rate liberalization. Tariffs have been reduced, subsidies eliminated, and quotas and mandatory import deposit requirements lifted. These measures have reduced price distortions on traded goods and led to improved export earnings.

Structural reform has also been taking place in the financial sector over the past several years. The recent introduction of privately funded pension systems by both Peru and Argentina, along the lines of the system first put in place by Chile in 1981, offers considerable promise in helping to broaden and deepen financial markets in these countries, providing sources of long-term local capital for domestic borrowers and reducing their dependence on foreign capital. The reprivatization of commercial banks in Mexico in 1991 and 1992 has also contributed to the deepening of financial markets there during the past two years.

These widespread reform efforts have enabled many Latin American countries to regain access to the international financial markets in a far shorter time than might have been imagined possible a decade ago. In total, an estimated $34 billion in portfolio and foreign direct investment flowed into the region in 1992, significantly adding to the reserves of many countries.

The inflows of foreign capital have not only facilitated the ability of many Latin American countries to service their external debt, but also brought with them such non-quantifiable benefits as new technologies, management know-how, and training for workers. These benefits have helped boost both domestic output and export capacity.

Initially, a good portion of the capital inflows, beginning in 1990, represented the repatriation of flight capital. More recently, the inflows have stemmed largely from investors in developed countries seeking to diversify portfolios and increase returns in view of the low interest rate environment prevailing throughout the industrial world. Unquestionably, the inflows have also been encouraged by policy changes in most Latin American countries designed to attract foreign capital, such as eased restrictions on foreign holdings of domestic assets, reduced fees and taxes on transactions by foreigners, and freer access to foreign exchange for the remittance of profits and dividends. In addition, foreign capital has been attracted to the region in no small measure because of the significant strides so many countries have made in normalizing relations with their creditors--with banks through Brady plan packages and with officials through Paris Club agreements.

While I cannot help but be impressed by the progress made throughout Latin America over the recent past, I am mindful of the fact that these gains provide no cause for complacency, no margin for relaxation in effort. Sustaining these gains and building on them will not prove easy, either politically or economically. Holding the course in the face of mounting social tensions will require political courage and sound judgment. Why do I say this?

For one, most industrial countries today face a situation in which the levels of public sector debt and persistently large budget deficits have reached the point at which public funds for new international--and domestic--needs, however justified, are essentially unavailable. As a result, countries in Latin America, as elsewhere in the developing world, in need of external finance will have to ensure that their markets continue to attract private capital inflows. Ultimately, these inflows will depend on the sustained implementation of sound monetary and fiscal policies.

In addition, slow growth in much of the industrial world has meant weak demand for developing countries' exports. This underscores the need for Latin American governments to pay close attention to the international competitiveness of their goods and thus to the competitiveness of their exchange rates. Chile and Colombia have been particularly successful during the past few years in these respects, diversifying their export base, broadening their trading markets, and maintaining reasonably competitive exchange rates. For other countries, such as Argentina and Mexico, substantial capital inflows have put upward pressures on exchange rates, reducing the competitiveness of traded goods and leading to a reversal of trade surpluses and a widening of current account deficits.

The successful conclusion of the Uruguay Round would be helpful in spurring growth in world trade and fending off protectionist pressures, providing a significant boost to Latin American--and other developing country--exports. I am also firmly convinced that the successful conclusion of NAFTA would bring important net benefits to its signatories.

A further concern I have has to do with fiscal deficits. While there has been widespread improvement in the region, fiscal balances still pose problems for a few major countries, including Venezuela and Brazil. In Venezuela, weak oil prices, combined with a stalled privatization program and political uncertainty, reversed two years of small fiscal surpluses in 1992, a situation that is not likely to improve this year. In Brazil, plans to cut federal spending, accelerate the privatization program, and strengthen federal control of state and municipal borrowing depend in part on the passage of legislation by a highly fragmented Congress.

Finally, in terms of structural adjustment, the reform effort has only just begun. Much work lies ahead with respect to a host of issues, such as improving basic infrastructure, dealing with income disparities, addressing environmental concerns, expanding health and education benefits, and providing adequate social safety nets. Labor laws, particularly less rigid work rules, are also in need of attention, as current practices in a number of countries make the task of restructuring companies especially difficult.

What is the role for central banks in this environment? First and foremost, the task of all central banks is to maintain domestic price stability. This goal must remain at the core of central bank policy. Integral to achieving price stability, as some countries in Latin America have already recognized, is the need for central banks to avoid the direct financing of government budget deficits. Central banks simply can't indulge in this practice and simultaneously hold inflation in check.

Control of inflation is particularly critical at this juncture. Because of the difficulties associated with resolving social tensions during periods of adjustment, inflation must be fought not only for the usual macroeconomic reasons, but also to avoid the social and political effects of its highly regressive tax aspects.

At the same time, central banks must strive to maintain positive real interest rates, which tend to increase private savings and discourage investments with low expected returns, thereby promoting growth in the economy. As a further task, central banks must work with their governments to help keep the real exchange rate competitive if their countries are to be able not only to increase exports, but also to finance external debt and build reserves.

Finally, central banks must continue the careful oversight of their banking and financial systems and, together with their governments, encourage the further liberalization of their financial markets. Confidence in the soundness of the banking and financial system is what mobilizes a society's savings and allows these savings to be channeled into productive investments. Only with confidence will private investment flourish and growth be stimulated.

All of these goals call for vigilance and leadership on the part of officials charged with responsibility for ensuring monetary and price stability within their countries. Central bank independence facilitates the achievement of these goals. I am pleased to note that so many Latin American countries have recently either adopted or announced their intention to put in place measures designed to move their central banks in the direction of increased autonomy.

In sum, the tasks that lie before us are not easy, but neither are they insurmountable. Consider the distance we have already covered in such a comparatively short period of time. Nevertheless, I know that all of us assembled here today are well aware of the distance we have yet to go. With a clear sense of direction, there is much we can accomplish together. I welcome the opportunity to join efforts with each and every one of you to help meet these challenges.

Thank you.