

PREFACE

THE 2007 REPORT ON ECONOMIC AND SOCIAL PROGRESS IN LATIN AMERICA

analyzes the nature and evolution of sovereign debt in Latin America and discusses the policies that can be followed by countries and international financial institutions (IFIs) to reduce the vulnerabilities associated with it. Although this is not a time of debt crises or financial emergencies, the report is timely because policies implemented in tranquil times can help prevent future problems. There is currently a receptive attitude in international markets to new financial instruments, such as obligations denominated in domestic currencies, which opens up opportunities for improving the profile and risk characteristics of Latin American public debt. This report seeks to contribute, as well, to the debate regarding the current international financial architecture, and to discuss ideas and initiatives aimed at improving the management of key risks such as those associated with rollovers, currency denomination, commodity price volatility, and economic shocks.

Governments can use debt for valuable purposes, including financing of investment in infrastructure and expenditures in human capital, and responding to cyclical downturns and to exceptional events such as natural disasters or financial crashes. Excessive public debt, however, can have serious consequences: it can create a burden on future generations, it may crowd out private investment, and, perhaps most importantly, it may increase the propensity for financial crises. The report concludes that governments can leverage the benefits of public debt, while minimizing vulnerability to crises, by improving debt management, developing domestic bond markets, and applying prudent fiscal policies backed by transparent rules.

The IFIs, for their part, have an important role to play in reforming the international financial architecture with a view to limiting the risks of sovereign finance. They can contribute to reducing global vulnerabilities by focusing on the creation of fast-disbursing liquidity facilities to soften the impact of sudden stops and prevent contagion. They can help to overcome the inefficiency of self-insurance strategies by promoting and supporting reserve-pooling agreements. The IFIs can also promote, through various means, the development of markets for contingent and local currency financial instruments, for instance, by including these features in their own bonds placed in the markets and passing these features through their loans to countries in the region.

This is a broad agenda, and it is unlikely that every aspect of it will gain international consensus. But the lessons of recent years indicate that the risks of inaction are higher than the risks of adopting a reform initiative that seems too ambitious. If some of the proposals

end up being unnecessary, they will not be applied in practice, but if they are needed and they are not available, the consequences could be serious.

This report contains a review of existing and new data, a survey of standard literature and conventional views on past debt crises, and a window into the new analysis and ideas that are a result of the research work that is ongoing at the Inter-American Development Bank and elsewhere. As such, it can serve as a tool for dialogue, a reference for researchers, a guide for policymakers, and a source of ideas for the design of systemic reforms.

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