VIII The Political Economy of Implementing Pro-Growth and Anti-Poverty Policy Strategies in Central America

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As described in the previous sections of this paper, Central America has made significant political, economic, and social progress since the start of the 1990s, but considerable challenges remain. Although the region has made important advances with economic reforms, there have also been major setbacks, and policy implementation has been fitful in some countries. Why is it that governments across the region have often found it difficult to implement their policy agendas, focused as they are on the goals of rapid growth, macroeconomic stability, and poverty reduction—goals that appear to be widely supported in the society? This section looks at the complex political, institutional, and social landscape in those countries. It highlights the main obstacles in the political process as governments try to integrate the interests of diverse groups into policies that are more firmly based on a broad national consensus. It also makes some recommendations for the work of the IMF—how it can fulfill its role of supporting institutional strengthening to underpin sound economic policies, and how it can incorporate lessons from the political economy of the region into its program work.

Setting

Viewed against the experience of the 1980s, Central America—which here refers to Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua—has achieved much during the past decade and a half. During the 1980s, much of the region was caught in protracted civil conflicts or subject to autocratic rule. The conflicts, coupled with frequent economic shocks and often inappropriate economic policies, caused profound economic dislocation and a sharp rise in poverty. After the civil wars ended, during the 1990s democracy took hold throughout the region, and orderly political successions were achieved. At the same time, macroeconomic policies were strengthened and structural reforms gained momentum, leading to a recovery of output, lower inflation, and stronger external positions. Rising nontraditional exports helped diversify the region's economic base.

However, since the end of the 1990s, the recovery has slowed. Adverse shocks (hurricanes, earthquakes, worsening terms of trade, and the global slowdown) compounded domestic problems as some countries found it difficult to sustain the reform effort, fiscal positions deteriorated, and some banking systems came under stress. As a result, growth slowed in much of the region (see Section I).

In 2003–04 growth rebounded, spurred by the global recovery, and most countries launched a new effort at fiscal consolidation and structural reforms. These reforms, if sustained, will provide a good basis for continued growth, supported also by the free trade agreement with the United States (CAFTA-DR). Nevertheless, the region remains vulnerable to shocks and policy reversals, and it faces increased competition in the global market for textiles and clothing since trading quotas were lifted at the beginning of 2005. To remain competitive and prosper as the region further integrates into the global economy, Central America will need to deal with the political fragmentation and vested interests that at times have stood in the way of a domestic consensus on key structural reforms.

Despite a notable improvement during the 1990s, social conditions continue to lag (except in Costa Rica). Poverty has fallen in relative terms (percentage of population) while it has increased in absolute terms (number of poor) (PNUD, 2003), and about half of the region's population continues to live in poverty (Table 8.1). Poverty tends to be concentrated in rural areas where access to basic public services (including health and education) is inadequate in most countries, and is often linked to underemployment or low-wage employment in the informal sector. Poverty and a lack of economic opportunities have fueled emigration, and in some countries worker remittances have be-

Table 8.1. Comparative Social Indicators

	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Average for Latin America and the Caribbean
Rank in UNDP Human Development Index (out of 177 countries)	45	103	121	115	118	79
GDP per capita PPP, U.S. dollars (2002)	8,840	4,890	4,080	2,600	2,470	7,223
People not expected to survive to age 40 (in percent of population) (2000–05)	3.7	9.9	14.1	13.8	10.3	9.7
Life expectancy at birth (years) (2002)	78.0	70.6	65.7	68.8	69.4	70.5
Infant mortality (per 1,000 live births) (2002)	9	33	36	32	32	27
Percent of population without access to safe water (2000)	5	23	8	12	23	14
Per capita health exp. in PPP, U.S. dollars (2001)	562	376	199	153	158	. . .
Physicians per 100,000 people (1990–2003)	160	126	109	87	62	. . .
Adult illiteracy (2002)	4.2	20.3	30.1	20	23.3	11.4
Primary school net enrollment (2001/02) (in percent of relevant age of the population)[1]	91	89	85	87	82	94
Secondary school net enrollment (2001/02) (in percent of relevant age of the population)[1]	51	46	28	36	37	61
Share of income or consumption (in percent)[2]						
Poorest 10 percent	1.4	0.9	0.9	0.9	1.2	. . .
Richest 10 percent	34.8	40.6	48.3	42.2	45	. . .
Gini index (*Human Development Report,* 2004)[3]	46.5	53.2	48.3	55.0	55.1	. . .
Percentage of population below the poverty line[3]	18.5	37.2	56.0	63.9	47.9	44.7

Sources: UNDP, *Human Development Report* 2001, 2002, 2003, and 2004.

[1]Data of net enrollment ratios are based on the new International Standard Classification of Education, adopted in 1997 (UNESCO, 1997), and may not be strictly comparable with those for earlier years. Data for some countries may refer to national or UNESCO Institute for Statistics estimates. For details, see http://www.uis.unesco.org. Because data are from different sources, comparisons across countries should be made with caution.

[2]Survey based on income.

[3]Data refer to the most recent year available during the period specified. The average is for Central America.

come a major source of foreign exchange. Literacy rates and health indicators have been improving, albeit from low levels. In some countries, urban crime and violence are endemic; although delinquency has been reduced recently in some countries (such as El Salvador and Honduras), it remains a serious concern and is often related to drug trafficking, which has become a significant problem.

With the advent of peace and democracy, social expectations have risen. Urbanization has increased the demand for public services, and increased political openness has allowed for greater dissent, social criticism, and open expression of social demands. The increased availability of information about higher living standards outside the region tends to raise expectations. At the same time, many institutions remain hobbled by political polarization fueled by a simmering distributional conflict that tends to permeate the political discourse. The associated social tensions have tended to stymie the political process and set back efforts to move economic reforms forward and to fulfill the rising expectations.

Governance problems continue to exacerbate the weakness of institutions in much of the region, despite notable progress over the past decade (Table 8.2). Corruption, lack of transparency, and questions about legal protection have tended to undermine the business climate and discourage foreign investment.[1] Cor-

[1]In the 2004 corruption perception index, produced by Transparency International (2004) on the basis of surveys, Costa Rica and El Salvador have the lowest perception of corruption among Central American countries (see www.transparency.org).

ruption also tends to affect the poor and disadvantaged disproportionately and frustrate their efforts at economic and social progress. Most countries also face a need to strengthen institutions and build confidence in judicial processes. Court decisions have at times complicated the pursuit of consistent economic policies—for example, by creating an unpredictable tax environment (Guatemala) and by delaying banking reforms. Governments across the region have recognized this challenge and made better governance one element of their economic and social reform strategies.

The unequal distribution of income and power in most of the region constrains social capital and generates pressures for redistribution.[2] Inequality weakens social cohesion, and most countries have yet to build the social cohesion needed to reduce political polarization. Distrust has made consensus more difficult to achieve, especially on policies and reforms that have distributional implications, and there is uncertainty about which groups receive their benefits. Sustained unfulfilled—and at times unrealistic—demands for redistribution strain the political process and undermine the economic policymaking process.

Political Support for Pro-Growth and Anti-Poverty Strategies

Recent research on Central America has highlighted the key elements of a comprehensive policy strategy that would help boost growth and reduce poverty (see Box 8.1).[3] The following are key elements of that strategy:

- Securing macroeconomic stability and reducing economic vulnerabilities. Large macroeconomic imbalances have had adverse effects on growth and poverty reduction in some countries.
- Improving the investment climate. Strengthening the rule of law (including contract enforcement) and the property rights regime and improving governance have been cited as key to achieving this.
- Expanding public investment, including investment in physical and social infrastructure (education and health).
- Improving social programs to expand coverage of educational and health services to the poor.
- Broadening access to credit.
- Using trade integration as an engine of growth and catalyst for institutional reform, in particular the regional integration and implementation of CAFTA-DR.
- Improving emergency preparedness, particularly by adopting measures to mitigate the costs of natural disasters.

There is broad consensus in the region on the strategic economic policy goals—maintaining macroeconomic stability by reducing economic vulnerabilities, boosting growth, and reducing poverty—and on the key elements of the strategy to reach those goals. Recent elections in all countries have echoed these objectives as well as the broad strategy for achieving them.

At the same time, the sociopolitical context in Central America creates challenges for the implementation of sound economic policies. In some countries there is distrust of the integrity of public institutions and politicians. Governments at times have a bias toward policies with short-term impact (consumption over investment) because of short election cycles and rules that do not allow for the possibility of (consecutive in most cases) reelection of presidents. Powerful interest groups put pressure on governments and legislatures, thus constraining policy reforms, while divided or fragmented legislatures hamper efficient policymaking. Adversarial relationships between executive and legislative branches often undermine the kind of constructive dialogue needed to build consensus on key issues, and widespread earmarking of public resources often reflects a relationship that is not only adversarial but also distrustful. Finally, in some countries the judicial branch has tended to rule on matters with serious economic impact (such as court decisions on tax policy in Guatemala or bank resolution in Nicaragua).

Fiscal Policy

Weaknesses in the public finances remain a common source of vulnerability in the region. Despite progress in several countries in reducing fiscal deficits over the past few years, public debt remains high in all countries (except Guatemala), tax systems are narrowly based, and tax compliance is poor. Public expenditures are subject to capture by interest groups, including through widespread earmarking, thereby constraining the availability of resources for growth and anti-poverty programs.

Although significant progress has been made on fiscal policymaking in recent years, much remains to

[2]Social capital refers to the institutions, relationships, and norms that shape the quality and quantity of a society's social interactions. According to the World Bank, there is increasing evidence that social cohesion is critical for societies to prosper economically and for development to be sustainable (www.worldbank.org/socialcapital).

[3]See for instance Agosin, Machado, and Nazal (2004), Loayza, Fajnzylber, and Calderón (2002), De Ferranti and others (2003), and World Bank (2004).

Table 8.2. Comparative Governance Indicators[1]

	Voice and Accountability	Political Stability	Government Effectiveness	Regulatory Quality	Rule of Law	Control of Corruption
Costa Rica						
2004	84.0	83.0	68.3	71.4	65.7	77.3
2002	84.8	86.5	66.5	72.7	72.2	79.4
1997/98	87.8	81.2	73.5	90.9	71.5	76.6
El Salvador						
2004	53.4	39.8	47.6	68.5	42.5	43.8
2002	51.5	56.8	35.6	56.2	39.7	36.6
1997/98	49.4	48.1	44.5	99.4	29.7	41.6
Guatemala						
2004	36.4	21.8	18.8	48.8	18.8	27.1
2002	35.4	32.4	32.0	52.1	21.6	30.9
1997/98	33.1	22.1	45.8	66.7	10.3	18.8
Honduras						
2004	46.1	26.7	27.9	39.4	33.8	30.0
2002	46.0	38.4	27.3	41.8	23.7	27.3
1997/98	51.2	36.4	36.1	43.6	17.0	11.0
Nicaragua						
2004	48.5	41.7	27.4	46.3	30.4	46.3
2002	52.0	47.6	17.5	39.7	32.0	39.7
1997/98	57.6	37.7	29.7	37.0	25.5	18.2
Average for Central America						
2004	53.7	42.6	38.0	54.9	38.2	44.9
2002	53.9	52.3	35.8	52.5	37.8	42.8
1997/98	55.8	45.1	45.9	67.5	30.8	33.2
Average for Latin America and the Caribbean						
2004	60.5	58.3	55.6	57.6	54.3	57.4
2002	61.2	51.2	53.3	58.4	53.2	54.9
1997/98	59.1	45.0	48.3	66.4	43.9	46.7

Source: Kaufmann, Kraay, and Mastruzzi (2005).
[1]Percentile rank with a higher number denoting better governance.

be done to achieve fiscal sustainability, strengthen the tax effort, and improve the quality of spending. Improvements in revenues depend on addressing tax compliance and strengthening tax administrations, broadening the tax base, reducing tax incentives and widespread exemptions, and, in some cases, on implementing selective increases in tax rates. The quality of spending can be improved by enhancing transparency, reducing earmarking, and better focusing subsidies, while also reforming the civil service, pension systems, and public enterprises. Progress on these issues is being made, including in the following cases:

- El Salvador, Honduras, and Nicaragua have recently implemented tax reforms, and tax initiatives have been under way in Costa Rica and Guatemala for some time.
- Virtually all countries are implementing programs to strengthen public expenditure management. Programs focus on enhancing the information systems and making them more transparent and on modernizing the budget process.

Nonetheless, important challenges remain in strengthening public finances:

- Business groups have resisted higher taxation in many countries, partly because of their distrust of public institutions and the belief that public spending is inefficient and captured by interest groups, and therefore not supportive of growth or social objectives.[4] To address this situation,

[4]Some events feed into the belief that the public sector is a poor custodian of the nation's resources. For example, unions representing public sector employees in Honduras (for example, teachers and health workers) have succeeded in raising the government wage bill by about 5 percent of GDP over a recent five-year period, and major corruption scandals have surfaced in several countries in recent years.

Box 8.1. Institutional Aspects of Strategies to Boost Growth and Reduce Poverty

A successful growth and anti-poverty agenda should incorporate the following core elements.

1. Ensuring macroeconomic stability. The following are key reforms:
   - *Promote financial sector stability* by strengthening regulation and supervision of the banking system, and improving bank resolution procedures and the payment system.
   - *Ensure fiscal discipline and sustainability* through fiscal rules, including passing fiscal responsibility laws, eliminating tax incentives and exemptions, reducing earmarking of revenues, strengthening public debt management, integrating budgets with medium-term plans, and improving the quality of the public investment.
   - *Ensure low inflation* by directing central bank activity to control inflation.
   - *Improve the wage-setting mechanisms* by ensuring that wage increases are linked to productivity increases, including by strengthening dialogue.
2. Improving the functioning of markets. The following reforms are needed to enhance productivity:
   - *Streamline the investment approval process*, simplify entry and exit procedures, and reduce the reliance on taxes and other concessions to attract investments.
   - *Establish strong regulatory mechanisms* for utility companies and other monopolies.
   - *Further liberalize trade* to facilitate greater integration with the region and the world.
   - *Further integrate regional financial markets* by harmonizing prudential regulations and coordinating the supervision of cross-border banking.
   - *Improve accounting and business reporting standards* for greater market discipline.
   - Reduce the transaction cost in transferring property, especially collateral.
3. Redefining the role of the public sector. To strengthen fiscal performance, the following key measures should be pursued:
   - *Strengthen the management of public expenditures* by eliminating nonproductive expenditures and shifting resources to investment and anti-poverty programs.
   - *Divest public services* that are unconnected to core functions of the public sector.
   - *Improve accountability and financial management* of public enterprises.
   - Enhance public sector transparency in reporting to the general public.
4. Strengthening disaster mitigation and management. Domestic agencies must strengthen capacity and preparedness. Regional coordination will improve with mechanisms for cooperating and exchanging information, especially during multicountry events that require coordinated responses.

governments are devoting greater effort to building domestic consensus for tax reform.[5]

- Interest groups have succeeded in capturing segments of the national budgets (for example, public universities in Honduras and Nicaragua, and teachers in Honduras and Guatemala) through the earmarking of spending that is sometimes provided for in the constitution.

Financial Sector Reforms

After a period of financial stress, the region has made important progress in reforming the financial sector (see Section VI). With the exception of El Salvador, all countries have experienced banking crises (Nicaragua) or episodes of banking stress (Costa Rica, Guatemala, and Honduras) in recent years. This has led to considerable efforts to upgrade prudential norms and improve banking supervision. All countries are moving toward a risk-based supervision framework, and most have concluded agreements to exchange information among supervisory authorities. Legal and bank resolution frameworks for the financial sector are being upgraded throughout the region. Recent moves toward financial integration and competition in the financial sector have heightened the awareness of the need for harmonizing financial norms in the region to prevent regulatory arbitrage and other distortions that affect competitiveness.

Despite the progress achieved, further efforts are needed. Banking systems remain fragile and a source of vulnerability.[6] Addressing this fragility

[5]These efforts (for example, in Guatemala, Honduras, and Nicaragua) have linked higher taxes with higher social spending and have been combined with assertive anti-corruption campaigns. Notwithstanding these efforts, tax reforms have so far made only modest progress in some countries (Costa Rica and Guatemala), and in others the reforms have been limited because governments were able to secure congressional support for only limited reforms and had to compromise on their initial objective of significantly expanding the tax base (El Salvador, Honduras, and Nicaragua).

[6]Banking fragility is reflected in highly nonperforming loans, balance sheet mismatches, less well-supervised offshore and parallel banking activities, and limited supervisory capacity.

Box 8.2. Consolidated Supervision of the Financial Sector

Regional financial conglomerates have emerged that successfully compete with international banks (see Section VI). The main factors behind this development include increased regional economic integration, political risk in some countries, economies of scale, and the facilities offered by Panama (particularly international licenses to conduct operations throughout the region).

Although financial integration is a positive development, it gives rise to the need for consolidated supervision and harmonization of norms and regulations to avoid the emergence of regulatory arbitrage and distortions of competitiveness. Financial integration would allow the assessment of the soundness of the whole financial conglomerate as well as the systemic and contagion risks associated with potential insolvency of a group. In the absence of consolidated supervision, intra-group transactions that inflate capital could go undetected for long periods of time.

Introducing effective consolidated supervision will require a concerted regional effort, including establishing minimum standards, strengthening the exchange of information among supervisors, and harmonizing core prudential regulations (such as on related lending).

However, important challenges remain in introducing consolidated supervision:

- Banks are likely to resist this process because it would reduce their discretion in choosing whether and where to consolidate their operations.
- Bankers are likely to oppose the consolidation in countries that are perceived as higher risk as a result of lingering political polarization (for example, El Salvador and Nicaragua).
- Applying regional limits to related lending would also create tensions, given the size and limited diversification of the region's economy.
- Regulators have tended to be reluctant to share information, in part because of limited legal protection.

will require actions on various fronts, including further strengthening of loan classification, prudential standards, bank resolution frameworks, and upgrading of supervisory capabilities, particularly consolidated supervision in both domestic and cross-border operations of related financial firms (Box 8.2). Widespread informal dollarization presents particular challenges that require a comprehensive policy strategy to restore the attractiveness of local-currency assets.[7]

A number of challenges remain to strengthen the financial sector.

- At times, bank stockholders have been reluctant or unable to increase bank capital to levels that allow for appropriate loan classification and provisioning while maintaining statutory capital adequacy ratios. Banks are an influential pressure group, and in some cases they have succeeded in delaying the introduction of more rigorous prudential norms and secured public funding for deposit insurance schemes (for example, Guatemala and Honduras). Granting bank supervisors appropriate legal protection is also an urgent priority.
- Applying limits to related lending creates tensions in many countries. Banks are often owned by a few large business groups that are also the banks' clients (for example, in El Salvador, Guatemala, Honduras, and Nicaragua).
- The presence of state banks (Costa Rica and Guatemala), which in the past have enjoyed special privileges (such as offering dollar deposits or enjoying an implicit full state guarantee of deposits) and may have engaged in political lending, may weaken the authority of supervisory agencies.

Trade Openness

The movement toward regional integration has gained momentum, most recently with the signing of a free trade agreement with the United States (CAFTA-DR) and with the efforts to complete a customs union in the region. Since the 1990s, the Central American Common Market has seen substantive progress with the virtual elimination of all intraregional tariffs, and a common external tariff currently covers 95 percent of all imports, with an average rate of less than 5 percent. These international trade agreements can be an important external anchor and catalyst for institutional change by breaking through domestic impediments to reforms.

The main support for CAFTA-DR comes from the export sectors, whereas opposition is centered on a coalition of political, civil society, and selective business groups. Among other things, CAFTA-DR

[7]The response to the challenges posed by informal dollarization includes strengthening macroeconomic policies to boost confidence in the domestic currencies, modifying prudential rules to reflect the risks of dollarization and minimize the risk of currency mismatches; and increasing cushions against possible deposit outflows by raising international reserves and/or arranging for international credit lines.

will make permanent the current trade preferences extended to the region by the United States under the Caribbean Basin Initiative. CAFTA-DR is therefore strongly supported by business groups representing the export processing zones (*maquilas*) and commercial agriculture. Most of the opposition has come from a coalition of groups that are skeptical about forging closer ties with the United States on political grounds, public sector unions, and civil society and interest groups concerned about the conditions negotiated in the agreement and its impact on some sectors, including the traditional agricultural sector. In addition, selected agro-industrial firms (for example, meat, dairy, and poultry industries) have expressed concern about losing their protected positions under CAFTA-DR.

To reduce the opposition to CAFTA-DR and garner support for the agreement, selected groups are being afforded continued protection. Gradual tariff reductions and quotas were used to cushion the impact on sensitive sectors. For example, poultry producers will be protected through tariffs and quotas for a transition period of up to 20 years. Similarly, corn (maize) has been excluded from the agreement with Nicaragua, and in Honduras quotas (beyond which a high tariff applies) have been established.

Generating Consensus on a Long-Term Reform Strategy

A broad national debate is generally needed to forge a consensus on policy strategies. This consensus must be entrenched in a policy framework based on credible and enduring rules. The fairly wide underlying agreement on long-term goals (growth, stability, and poverty reduction) provides a mandate and opportunity for governments to lay down medium-term policy markers and objectives. The consensus needs to be reflected in institutional arrangements and legislation as anchors to policymaking, which could include fiscal pacts, fiscal responsibility laws, and procedural safeguards. To achieve this, policymakers need to better communicate the benefits of the pro-growth and anti-poverty policies, including discussing the short-term costs versus the long-term benefits.

Key institutions that serve the long-term goals need to be strengthened. Countries need to focus on building the kinds of institutions and processes that deliver better policy outcomes and help sustain them over time. The status quo sometimes delivers inferior outcomes as key interest groups make ad hoc policy decisions that focus on short-term goals. For policies to improve, they need to be framed in a wider context and constrained by rules-based and accountable processes and institutions that push for long-term goals. Though institutional reforms do not always lend themselves to "best practice" formulations because of the diversity of specific country circumstances and conditions, recent research has highlighted the importance of strong institutions for economic growth.[8] In particular, institutional arrangements that are growth enhancing tend to share the following elements.

- *Fiscal policies* supportive of macroeconomic stability and focused on key spending priorities (investment and social programs). Institutions must focus on countering the classic threats to fiscal discipline, including the common-pool and intertemporal problems,[9] which, if left unchecked, could result in weak public sector balance sheets, destabilizing deficits, and unsustainable debt.
- *Monetary policy* and institutions that give priority to achieving and sustaining price stability. These have to overcome potential obstacles such as the lack of central bank independence; fiscal dominance; and pursuit of multiple or even contradictory policy objectives.
- *Financial sector policies* and institutions that contribute to sound and efficient banking systems. These basically have to counter problems of asymmetric information and moral hazard in banking by providing adequate incentives to banking system participants to act as if a government bailout would be an event both very rare and costly for them,
- *Trade policy* and institutions that promote open trade regimes. Trade policy is the classic arena for rent-seeking since protection can bring large benefits to individual firms and industries, while the costs of protection are borne in the form of more widely and thinly spread economic dislocations and inefficient allocation of resources.

There is a need to strengthen the political process and governance. Often, political responsibility is diluted in regimes where the executive and legislative branches are controlled by different groups and do not function in a coordinated or effective way. Current discussions on political change have centered on lengthening electoral cycles (such as by allowing one consecutive reelection of the president), modify-

[8]See, for instance, Chapter 2 of Kalter and others (2004) and Chapter 3 of IMF (2003).

[9]Common-pool problems arise when particular groups lobby for public sector actions to their own benefit without internalizing the associated costs (for example, subnational governments with inadequate budget constraints). Intertemporal problems include inadequate incentives to be concerned with future implications of policies, which are often attributed to situations of very frequent political turnover.

ing the financing of elections, strengthening technical capabilities of legislatures and political parties, and taking other measures to improve cooperation between branches of government.[10]

External factors can help to promote and anchor policy reform and possibly contribute to improving the political process. The requirements of CAFTA-DR, the World Trade Organization, the IMF and other international financial institutions, and the donor community can help catalyze institutional reforms, lock in best practices, and bring greater transparency to public policies. The latter might contribute to improving the political process by making the system more accountable. Effective support of these policy strategies could perhaps benefit from better focus of external assistance and associated conditionality on a few core (institutional) issues in the reform agenda. Donor financing can help foster reforms, while also helping to finance social safety nets to cushion any short-term adverse effects of reforms.

Implications for the IMF

The IMF should remain engaged in Central America through its various operational modalities. The focus of the IMF's work in the region, and elsewhere, has increasingly concentrated on crisis prevention and institutional strengthening to help entrench macroeconomic stability and lay the conditions for economic growth. The IMF has developed a framework of internationally agreed-upon standards and codes in the areas of public finance, banking, and statistics that serve as benchmarks for institution building. Besides providing bilateral surveillance and program support—such as Poverty Reduction and Growth Facility (PRGF) arrangements in Honduras and Nicaragua and two Stand-By Arrangements in Guatemala in the past few years—the IMF has strengthened the regional dimension of its work in Central America, including by increasing research on key policy issues for the region, expanding technical assistance, engaging in outreach activities, and organizing regional conferences and seminars.

The IMF should leverage these efforts to help promote a strong policy agenda, primarily in the following ways:

- Help promote national debate on pro-growth and anti-poverty agendas. The IMF should encourage the authorities to strengthen their efforts to explain and build support for appropriate policies. Open public debate, transparency, and better communication of policy strategies would help raise public awareness of key policy issues and the opportunity cost of reforms, thus promoting ownership. Resident representative offices should play a key role in these efforts.
- Intensify outreach with main actors in the political process. The IMF's engagement—focused and well timed—with congressional leaders, labor unions, business leaders, civil society groups, media, donors, and the public at large can be very helpful to crystallize policy options and catalyze well-informed policy consensus. In an effort to strengthen the constituency for reforms, the IMF can do this through outreach seminars, op-ed articles in newspapers, and bilateral meetings with IMF missions. In this work, the IMF can bring to the region its experience on best practices in Latin America and world-wide.
- Support regional integration efforts with technical assistance in the areas of the IMF's expertise:
  - Address relevant macroeconomic issues that require a regional approach, such as tax harmonization and coordination, consolidated banking supervision, and cooperation on economic statistics.
  - Support the creation and strengthening of regional institutions and collaboration.
  - Step up efforts to help authorities identify sources of, and obstacles to, growth (for example, by helping to develop the reforms necessary to harness the potential benefits of CAFTA-DR).
- For the IMF's program work, two main conclusions emerge from the analysis of political economy issues:
  - In fragmented political landscapes (especially where governments and congresses are divided), the IMF needs to engage broadly to ensure and help create sufficient domestic consensus on programs. Although the government will remain the IMF's counterpart, the IMF needs to engage with other key players in the political process to ensure needed support for program implementation.
  - The IMF needs to be sensitive to the underlying institutional weaknesses and political cycles. Programs must focus on key policy reforms and be attuned to political cycles, which indicate when there are opportunities to introduce difficult policy changes and when, on the other hand, governments may need to focus more on protecting policy gains.

[10]The constraints of presidentialist political systems in Latin America are described in Linz and Valenzuela (1994), and Urcuyo (2003) reviews the challenges and proposed solutions to the Costa Rican political system.

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