Lessons From the 1990s Experience in Latin America

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Reform programs ...

- Monetary stabilization – either exchange rate- or inflation-based objectives
- Privatization; deregulation
- Financial liberalization
- Debt restructuring (Brady plan) – normalized relations with external creditors
Growth picked up in early 1990s, but only temporarily ...

Figure 2.5. International Comparison: Growth Performance
(Annual percent change in real per capita GDP)

Source: IMF, World Economic Outlook.
Irrational exuberance about reforms ...

Figure 2.6. Latin America:
Contribution of Reforms to Economic Growth
(In percentage points)

Early evidence in
Lora and Berrera (1997)

More recent evidence in
Lora and Panizza (2002)

Sources: Lora and Berrera (1997); and Lora and Panizza (2002).
But some fundamental measures were not taken ...

International Comparison: Index of Labor Market Rigidity

(0=low, 1=high)

Source: Botero and others (2003).

1The higher the index, the higher the level of labor market rigidities.
Followed by financial crises ...

The year \( t \) refers to the onset of crises which were as follows: Mexico (1995), Brazil (1999), and Ecuador (1999).

Source: Kochhar and others (2003).

1 The year \( t \) refers to the onset of crises which were as follows: Mexico (1995), Brazil (1999), and Ecuador (1999).
Different choices of stabilization plans had different endings ...

<table>
<thead>
<tr>
<th>Exchange rate-based</th>
<th>Inflation-based</th>
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<tr>
<td>Argentina</td>
<td>Chile</td>
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<td>Brazil</td>
<td>Colombia</td>
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<td>Mexico</td>
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<td>Uruguay</td>
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=> financial crisis *finale*  => no crisis
Cyclical boom under ERBS...

**Graph:**

*Latin America: Average Real GDP Growth During Exchange-Rate Based Stabilization Plans*

- X-axis: Years before and after program introduction
- Y-axis: Percent

The graph illustrates the percentage change in real GDP over several years before and after the introduction of exchange-rate based stabilization plans. It shows a cyclical pattern with growth before, peak, and decline after the program introduction.
Led by private consumption ...
With a deteriorating external balance...
Different paths for REERs ...

Figure 4.4. Latin America: Real Effective Exchange Rates

(Index=100 at start of stabilization)


1See text Table 4.1 for a discussion of stabilization periods.
Capital inflows ...
And rising external debt/exports ...
Public debt ratios drifted up – no “feedback mechanism” ...
Compounded by fiscal accounting problems ...
And undervaluation of foreign-currency debt ...
Where Was the Fund?

Argentina Fiscal Balance, Actual vs. Projected

(%) GDP

Actual
Informal dollarization also created vulnerabilities ...

Figure 6.6. Reserve Coverage of Foreign Currency Deposits for Latin American Countries (Average 1996–2001)

While trade integration remained weak...
Verdict on “ERBS”? ...

- Did bring inflation down quickly – and durably.
- Wasn’t supported by other policies – especially fiscal -- but the lack of support was endogenous. Who’s to blame?
- Choice of ERBS should be based on objective assessment of implementation of other policies.
- But an early exit strategy would have helped minimize costs.
General lessons ...

- Take time to do reforms right
- Debt has not played a useful role in these countries – fiscal policy needs to be anchored by conservative debt limits
- Fixed exchange rates don’t discipline other policies
- Don’t count on markets to force *ex ante* discipline on policies either
- Or on IFIs, for that matter!
- Hope for the best, but plan for the worst
Lessons for the Fund ... 

- Less forebearance of slippages ...
- Combined with a credible exit strategy from programs that are off track
- Don’t oversell our role, and avoid moral hazard
- Clearer identification of responsibility for going ahead with or stopping a program
- Feasibility of international system without an SDRM?
Lessons for Hong Kong?

- Avoid balance sheet mismatches
- No room for complacency
- Don’t count on the peg to discipline other policies
End of presentation